STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
FRANK A. MARCHELLO (DECEASED)	:	DETERMINATION DTA NO. 821443
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1995 through August 31, 2002.	:	

Petitioner, Frank A. Marchello (Deceased), filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1995 through August 31, 2002.[1]

A hearing was held before Winifred M. Maloney, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on January 8, 2008 through January 10, 2008, with all briefs to be submitted by May 29, 2009, which date began the six-month period for the issuance of this determination. Petitioner appeared by Hodgson Russ, LLP (Jack Trachtenberg, Esq., and Alvan Bobrow, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUES

I. Whether the Division of Tax Appeals lacks jurisdiction to consider the underlying issues because the statutory notice was issued to Frank Marchello rather than to his estate.

[1] Frank A. Marchello passed away on January 29, 2002 in New Jersey. William Fleming was appointed executor of his estate by the Honorable Susan J. Hoffman, Surrogate of the County of Hunterdon and Deputy Clerk of the Superior Court of New Jersey, Chancery Division, Probate Part, Hunterdon County, on July 12, 2002. Mr. Fleming filed the petition in this matter.

II. Whether the Notice of Determination should be cancelled because there is no underlying corporate liability.

III. Whether the Notice of Determination issued to Frank Marchello lacks a rational basis.

IV. Whether Frank Marchello is liable for the sales and use taxes due from Club V.I.P. of N.Y., Inc., as a person responsible for the collection and payment of sales tax pursuant to Tax Law §§ 1131 and 1133.

V. Whether the audit method employed by the Division of Taxation in its audit of Club V.I.P., Inc., was reasonable or whether petitioner has shown error in either the audit method or result.

VI. Whether penalty asserted in the subject Notice of Determination should be abated.

FINDINGS OF FACT

Pursuant to section 3000.15(d)(6) of the Rules of Practice and Procedure of the Tax Appeals Tribunal and section 307(1) of the State Administrative Procedure Act, petitioner submitted proposed findings of fact. The proposed findings of fact have been substantially incorporated into this determination with exceptions noted in the final finding of fact.

1. On February 10, 2005, the Division of Taxation (Division) issued to Frank A. Marchello a Notice of Determination which assessed $4,369,607.69 in sales and use taxes due, plus penalty and interest, for the period December 1, 1995 through August 31, 2002. The notice indicated that Mr. Marchello was being held liable as an officer or responsible person of Club V.I.P. of N.Y. Inc. (Club V.I.P.)

2. Club V.I.P., along with two other corporations, managed the operations of an adult entertainment night club, whose trade name was "VIP Club of NY" (VIP Club or the club), located at West 20th Street, New York, New York, during the period December 1, 1995 through

August 31, 2002. The VIP Club served food and beverages, and provided adult entertainment during the period at issue.

3. Upon graduating from high school in 1965, Mr. Marchello, a life long resident of New Jersey, began his career in the insulating business and, at first, even pumped gas at night to make extra money. In 1967, Mr. Marchello branched out on his own and started a trucking business. This business primarily operated ten-wheel tandem dump trucks that were used to move asphalt and stone for quarries and contractors. Eventually, Mr. Marchello became one of the most well respected tandem dump truck operators in the state of New Jersey. Mr. Marchello ran his trucking business for his entire life.

4. Mr. Marchello also became involved with other business endeavors in New Jersey during his lifetime. About seven to eight years after starting the trucking business, he began a contracting business that did construction work for the State of New Jersey, as well as its cities and municipalities. Mr. Marchello also purchased a fuel oil transportation business, which he ultimately built into one of the largest independent oil companies in New Jersey. As with Mr. Marchello's trucking company, the contracting and fuel oil businesses were based in New Jersey. Most of Mr. Marchello's customers were also located in New Jersey.

5. One of Mr. Marchello's other businesses was a company called "A" Street Entertainment, Inc. ("A" Street), which was established to sponsor aspiring singers and produce music videos. Mr. Marchello was the sole owner and director of "A" Street, a New Jersey domestic profit corporation incorporated on February 28, 1985, whose principal business address was Old Camplain Road, Somerville, New Jersey. "A" Street was not successful and ultimately ceased operating as an entertainment company. Mr. Marchello, however, continued to hold the company as a dormant entity.

6. In January 1993, Mr. Marchello decided to test his entrepreneurial skills by opening a gentlemen's (i.e., adult entertainment) club in New York City. To make the new endeavor a reality, Mr. Marchello acquired a company called Dezer Entertainment Concepts, Inc. (Dezer Entertainment) from an unrelated third party, Michael Dezer.[2] Dezer Entertainment held cabaret and liquor licenses, which were needed to run the club. Mr. Marchello purchased Dezer Entertainment through "A" Street, such that "A" Street became the sole owner of Dezer Entertainment. Thereafter, Dezer Entertainment entered into a ten-year lease agreement, dated January 6, 1993, with Dezer Properties, Inc., to lease premises for the club at West 20th Street in Manhattan.[3] With the lease and licenses in place, Mr. Marchello began to operate the club, which initially went by the trade name "Texas Gold." Mr. Marchello operated Texas Gold via a wholly-owned corporation called Tex-Mex Restaurant Corp. When Texas Gold failed to do as well as Mr. Marchello had hoped, it was shut down and reopened under the trade name "Silverado."

7. By 1995, Mr. Marchello had grown weary of the adult entertainment industry and no longer wanted to be involved in the business of running a gentlemen's club. He had, however, invested a lot of money in the club, including expenditures for furniture, fixtures and equipment, as well as to renovate and improve the club's premises. Mr. Marchello was looking for someone with experience in the industry to manage the club so that the club would continue to operate and become successful. Mr. Marchello's goal was to preserve the value of the club's assets so that he

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[2] Dezer Entertainment was incorporated in New York State on July 10, 1989. Dezer Entertainment changed its corporate name to Hillsborough Corp., but not until December 6, 2002, which is after the audit period.

[3] Dezer Properties was owned by Michael Dezer, a landowner and developer who also owned Dezer Entertainment before the company was sold to "A" Street.

could ultimately recoup his investment. He also had to contend with the fact that Dezer Entertainment was stuck with a long-term, ten-year lease for the club's premises.

8. In or about January 1996, Mr. Marchello made an agreement with Steve Aslan and Jon Vargo, both of whom had experience in the adult entertainment industry to take over the operations of Silverado. Under their agreement, which was first verbal, Mr. Aslan and Mr. Vargo were to run the gentlemen's club located at West 20th Street and pay all expenses associated with the day-to-day operations of the club, including a weekly payment of $2,884.62 to Mr. Marchello to repay him for the financial investment that he had made with respect to the assets and renovations of the club. These weekly payments were to be made to Mr. Marchello until he had recouped his investment in the amount of $750,000.00. The agreement further provided that, after all expenses were paid, Messrs. Aslan and Vargo were to keep the club's profits.

9. After taking control of Silverado, Mr. Aslan and Mr. Vargo changed the trade name of the club to the VIP Club. At the advice of his accountant, Mr. Aslan also set up three companies to manage the day-to-day operations of the VIP Club. These entities were 20/20 Food & Beverage, Inc. (20/20), incorporated in New York State on February 7, 1996, Prestige Food & Beverage, Inc.(Prestige), incorporated in New York State on February 20, 1996, and Club V.I.P., incorporated in New York State on February 20, 1996. Mr. Aslan's accountant advised him to structure the VIP Club's operations in this manner so that its nontaxable receipts would be segregated from its taxable receipts. Mr. Aslan was advised by his accountant - and it was his understanding and experience from having worked in the industry - that any receipts generated only from the sale of exotic dances would not be subject to sales tax, but that admissions charges, cover charges, sales of tangible personal property (i.e., club merchandise), and receipts from the

sale of food and drink would be taxable. Consequently, Mr. Aslan formed Club V.I.P. for the purposes of taking in the nontaxable exotic dancing receipts. He formed 20/20 for the purposes of receiving receipts from taxable admissions charges, cover charges and sales of club merchandise (e.g., t-shirts, shot glasses, etc.), and he formed Prestige for the purposes of taking those receipts that included sales of food or drink. The auditor concedes that Club V.I.P., 20/20 and Prestige were set up, and are properly viewed, as separate and independent companies.

10. The VIP Club opened for business on February 19, 1996. At that time, Mr. Aslan and his management companies, along with Mr. Vargo, operated and controlled the club pursuant to a verbal arrangement that they had previously reached with Mr. Marchello. On August 15, 1996, this verbal arrangement was formalized in a written Operating Agreement, executed by Frank Marchello in his individual capacity, and as president of "A" Street and Dezer Entertainment, and Steve Aslan in his individual capacity, and as president of Club V.I.P., 20/20 and Prestige.

11. The Operating Agreement required, among other things, that Mr. Aslan manage the day-to-day operations of the VIP Club, and pay out of the income of the club all expenses in connection with the management of the club including, among other things, rent, suppliers, employee salaries, employee withholding taxes, sales taxes, other "trust fund" taxes, and his own salary and expenses. The agreement also required Mr. Aslan to pay to Mr. Marchello the sum of $2,884.62 per week until Mr. Marchello was paid the sum of $750,000.00. The agreement further required that any profits, after the payment of all expenses (including Mr. Aslan's) and fees incurred in the management of the club, be paid to Mr. Marchello. The terms of the agreement also required Mr. Aslan to make himself available to Mr. Marchello for meetings and consultations, and to make the club's books and records available to Mr. Marchello for his review upon request. The term of the operating agreement was five years.

12. Mr. Marchello received payments towards the recoupment of his $750,000.00 investment and, at times, received additional amounts that Mr. Aslan and Mr. Vargo paid him. Mr. Aslan and Mr. Vargo made these additional payments to Mr. Marchello because they thought it would help maintain a positive relationship with Mr. Marchello. This was important to Mr. Aslan and Mr. Vargo because they were interested in buying the club from Mr. Marchello and they felt that making these additional payments might position them more favorably as prospective buyers. Other than these additional payments, Mr. Aslan and Mr. Vargo kept the profits from the club.

13. Mr. Aslan was the sole owner, shareholder, director and officer of Club V.I.P., 20/20 and Prestige. Mr. Marchello did not have any ownership interest in and was not an officer, employee or director of those companies. Through his management companies, Mr. Aslan managed and operated the VIP Club. When the club first opened, Mr. Aslan met with Mr. Marchello regularly to discuss the operation of the club. At those meetings, Mr. Marchello offered suggestions about actions that needed to be taken on behalf of the club. Mr. Marchello was satisfied with the direction of the club and trusted Mr. Aslan's management. Over time, Mr. Marchello's meetings with Mr. Aslan became less frequent. During the last year of Mr. Marchello's life, he rarely met with Mr. Aslan. Although Mr. Marchello had full access to the club's books and records, he never asked Mr. Aslan to review those books and records.

14. During the audit period, the VIP Club derived approximately two-thirds of its revenue from the sale of "dance dollars." The dance dollars were scrip (i.e., "funny money") that the club's customers could purchase and then use to purchase exotic dances, or to tip the dancers and wait staff. Customers who purchased dance dollars would be charged a surcharge, which was used to help cover expenses incurred by the club in connection with the dance dollars (e.g., costs

associated with printing the dance dollars). Approximately 99% of the club's customers purchased dance dollars with credit cards. The charges for these transactions were invoiced and received by Club V.I.P., which did not charge sales tax on the purchase of dance dollars. Employees of Prestige (and later 20/20) sold the dance dollars to the club's customers.

15. The dancers who performed at the VIP Club did so as independent contractors. The dancers were not paid a salary and were responsible for soliciting dances from the club's patrons. They were also required to pay a "house fee" to Club V.I.P. for each night that they performed at the club. The house fee was essentially a license fee incurred by the dancers for the right to use the club's facility. The dancers could pay the house fee with cash, but in most cases they did so with dance dollars that they earned from the club's patrons. The dancers would also pay a 10% handling fee to Club V.I.P. for the use of its merchant accounts, which allowed them to get paid in dance dollars if a customer did not have cash on hand. The dancers kept the remainder of the dance dollars that they earned. At the end of the evening, the dancers would turn in the dance dollars and receive cash or a check for 90 percent of the face value of the turned in dance dollars. The club's customers also purchased exotic dances with cash.

16. Any exotic dances that were purchased by customers of the VIP Club took place within the confines of the club. The VIP Club consisted of about 8,000 square feet and had one large main floor with a long bar on one side. There was also a mezzanine level that wrapped around a portion of the club. A second bar and tables were located on the mezzanine. From each end of the mezzanine, two stairwells led to the club's top balcony. When the VIP Club first opened, there was one VIP room on the balcony where customers could purchase private dances. Additional VIP rooms were added to the balcony and certain areas of the club's main floor during the audit period. Customers could purchase dances to be performed both inside a private

VIP room, as well as out "in the open," i.e., at locations within the club, but outside of the private VIP rooms.

17. Customers of the VIP Club were never required to purchase food or beverages in connection with a dance that was purchased for performance outside of a private room. In other words, when customers purchased a dance to be performed "in the open," all that the customer purchased was the dance. Club V.I.P. did not charge sales tax on these "dance only" transactions.

18. When customers wanted to purchase a private dance to be performed in a VIP room, they were not charged an admission fee to the room. They were, however, charged a fee for a bottle of champagne or if the customer did not drink champagne, a couple of rounds of drink. The patron was charged for the champagne at the same price they would have paid had they ordered it at the bar. Once inside the private room, the customer transacted separately and directly with the dancer for the fee to be paid for the dance. Thus, the charges for the champagne (or other drinks) and the dance were separately invoiced. Prestige, the entity set up to take in the club's food and beverage revenue, would charge the customer for the champagne and would charge sales tax on the transaction. Club V.I.P., on the other hand, would charge the customers for the dance dollars that were used to pay the dancer in the private room. Club V.I.P. did not charge sales tax on these private room, "dance only" transactions.

19. Club V.I.P. did not invoice or receive any revenue from patrons of the club other than the dance dollars that were used to purchase exotic dances. Thus, Club V.I.P. did not charge sales tax on any of its sales. All of the club's other charges were, however, treated as being subject to sales tax during the audit period. 20/20 invoiced and collected the club's admissions charges, cover charges and charges for club merchandise, and charged sales tax on all such

transactions. As previously indicated, Prestige invoiced and charged sales tax on all receipts collected for food and beverage. After Prestige filed for bankruptcy in 1999 and stopped operating in 2000, such charges were invoiced and collected by 20/20, which also charged sales tax on the food and beverage transactions.

20. As noted above, the Operating Agreement required Mr. Aslan and his management companies to pay all the expenses associated with the day-to-day operations of the club, including the rent for the premises. Prestige claimed a rental deduction of $187,095.00, $370,593.00 and $555,434.00, respectively, on its federal income tax returns for the years 1996, 1997 and 1998, respectively. 20/20 claimed a rental deduction of $111,807.00, $56,975.00 and $0.00, respectively, on its federal income tax returns for the years 1996, 1997 and 1998, respectively. Club V.I.P. claimed a rental deduction of $159,325.00, $96,267.00 and $126,300.00, respectively, on its federal income tax returns for the years 1996, 1997 and 1998, respectively.

21. In March 2007, Salvatore (a/k/a "Uncle Sal," a/k/a "Fat Sal") Scala and Thomas (a/k/a "Monk") Sassano were convicted in the United States District Court for the Southern District of New York on charges connected to their extortion of the VIP Club from the mid 1990s through 2002. Specifically, Messrs. Scala and Sassano were convicted of knowingly committing extortion as that term is defined in 18 USC § 1951(b)(2), by attaining money and property from and with the consent of the owner and operators of the VIP Club, which consent was induced by the wrongful use of actual and threatened force, violence, and fear, and thereby did obstruct, delay and affect commerce, and the movement of articles and commodities in commerce as that term is defined in 18 USC § 1951(b)(3). Mr. Scala, an assassin and "captain" in the Gambino organized crime family, and Mr. Sassano, a "soldier" in the Gambino organized crime family

who operated under Mr. Scala's command, were responsible, in the words of the United States Attorney for the Southern District of New York, of having "bled the club dry" and putting it out of business. In particular, Messrs. Scala and Sassano demanded regular "protection payments" from the VIP Club that ranged from $2,500.00 to over $15,000.00 every two weeks. These protection payments had to be paid in order to "keep the peace." According to Mr. Aslan, if the payments were not made, there would have been "serious, violent repercussions." Mr. Aslan felt intimidated by Messrs. Scala and Sassano and generally "feared for [his] health" He was afraid of physical violence and of being "beaten up" by them.

22. Mr. Aslan first learned that the VIP Club was being extorted by the mob when, a few weeks after opening the club, Mr. Vargo told him that they would have to start making protection payments to Mr. Scala. Mr. Vargo had been told, in the course of the negotiations to take over the club, that the payments would have to be made, but he did not tell Mr. Aslan at the time. Indeed, during the negotiations, Mr. Scala held himself out as Mr. Marchello's "representative." It became clear, however, that Mr. Scala did not really represent Mr. Marchello. Rather, Mr. Scala had been extorting Mr. Marchello when he ran the club as Silverado and was forcing himself into the negotiations with Mr. Aslan and Mr. Vargo to ensure that he would continue his hold over the operations of the club. Mr. Marchello was not a member of, or associated with, an organized crime family, nor was he ever suspected by the federal government of having any such affiliations.

23. In addition to extorting the VIP Club through their demand for protection payments, Messrs. Scala and Sassano forced the club to keep, on average, between five and seven mob associates on the payroll. This took place during the entire audit period. The individuals were ostensibly employed as "security," but in reality they did not perform any services for the club

whatsoever. Rather, Mr. Scala wanted these mob associates to be at the club to act as his "eyes and ears" when he could not be present. Mr. Scala kept them there as further intimidation and to watch the amount of money coming into the club. This was important to him because, whenever the club started to bring in more revenue, Mr. Scala would accordingly increase the protection payments that the club had to pay him. Although Mr. Scala was arrested for an unrelated crime in June 2000 and was convicted of such crime in 2001, Mr. Sassano continued to collect protection payments on Mr. Scala's behalf from the club through 2002.

24. Mr. Scala made it clear that the individuals whom he demanded be on the club's payroll were "untouchables" and could not be fired or removed from the club without his permission. Indeed, most of these "employees" had been forced onto the payroll of Silverado when Mr. Marchello ran the club. Mr. Scala required them to be kept on as "holdovers" once Mr. Aslan and Mr. Vargo took over the club. As with the protection payments, Mr. Aslan did not learn that he was also going to have to pay these other mob associates until after he began operating the VIP Club.

25. During the audit period, Mr. Scala's associates and friends were also permitted (on Mr. Scala's orders) to run up tabs for food and drink at the VIP Club. These tabs, which were never paid, varied in amount from a couple of thousand dollars to, at times, over $8,000.00. In total, the VIP Club lost tens of thousands of dollars in unpaid food and beverage tabs during the audit period.

26. The influence of organized crime over the VIP Club was not limited to the activities of the Gambino crime family. Mr. Vargo was also connected to the Genovese crime family, which demanded that the club make payments to it in the amount of roughly $5,000.00 per week. These payments began shortly after Mr. Scala began to demand his protection payments and lasted until

Mr. Vargo left the club around July 2002. Mr. Vargo collected the payments on behalf of the Genovese crime family and routinely used physical violence or the threat thereof to ensure that the payments were made.

27. Mr. Vargo also had a serious drug and gambling problem that resulted in his becoming indebted to a host of bookies who were connected to a variety of organized crime families. Mr. Vargo's gambling problem escalated about one year after he and Mr. Aslan took over the club and reached a peak toward the middle of 2002. This resulted in the VIP Club having to make weekly payments to Mr. Vargo's bookies. These payments averaged between $5,000.00 and $10,000.00, but at times approached $20,000.00. Over the course of the audit period, the VIP Club was forced to pay in excess of $1 million to Mr. Vargo's bookies. As with the weekly payments to the Genovese crime family, Mr. Vargo used violence and the threat of violence to make sure that his bookies were paid.

28. The extortion, racketeering and other illegal activities of the mob and Mr. Vargo completely dominated and controlled the affairs of the VIP Club. Over the course of the audit period, the VIP Club was forced to pay out close to $4 million dollars in extortion and other payments. The resulting financial impact was devastating and created a "major cash flow problem." The VIP Club regularly bounced checks that were issued to its employees and vendors. Many of the checks that were sent to Mr. Marchello to repay him for his investment in the club also bounced. The club was forced to choose the vendors that would get paid, which it did by monitoring the checks that were coming into its bank accounts for payment (via an online system) and directing the bank as to which checks to honor. As a matter of survival, the club was generally able to pay only those vendors that were necessary to keep its basic operations going, such as utilities and food and beverage vendors.

29. The financial burden placed on the VIP Club , i.e., the management companies, by the extortion and racketeering made it impossible for the club to satisfy its federal and New York State obligations. Indeed, both 20/20 and Prestige, which took in the taxable revenue of the club, frequently filed late sales tax returns with New York, and were often unable to remit the sales tax that was shown as owing on the returns. Mr. Aslan made every effort to meet these sales tax obligations because he knew that he would be held personally liable for the taxes if they were not paid. As a result, both 20/20 and Prestige entered into payment plans with New York to pay the back sales taxes. These back taxes were, however, never fully paid due to the impact of the extortion and racketeering activities.

30. At the hearing, Mr. Aslan testified that the extortion and racketeering activities would have prohibited Club V.I.P. from meeting its sales tax obligations, even if a determination had been made that its dance dollars were subject to sales tax.

31. After a four-year battle with lung cancer, Mr. Marchello passed away at his home in Ringoes, New Jersey, on January 29, 2002. Initially, Camille Landano was appointed executrix of Mr. Marchello's estate but she was removed because she was disrespectful to Mrs. Marchello and her family. After Ms. Landano was removed, John Manfreda served as executor of the estate for a short period of time. Mr. Marchello's childhood and lifelong friend, Bill Fleming was appointed executor of his estate on July 12, 2002. At the hearing, Mr. Fleming fondly remembered Mr. Marchello as: "the most honorable, honest, straightforward guy I've ever met in my life." According to Mr. Fleming, Mr. Marchello was a man of his word who believed strongly in living up to his promises and obligations. Indeed, Mr. Marchello would often tell his wife of over 35 years, as well as his friends and employees, to pay their mortgage and taxes before paying anything else. Mr. Aslan too remembered Mr. Marchello warmly, testifying that:

"Frank was the most honorable, honest, loyal guy I had ever met in my life." Mr. Aslan came to appreciate Mr. Marchello even more, as an "amazing, amazing individual" after attending his wake and hearing from numerous friends and family how much Frank always did for everyone.

32. Following Mr. Marchello's death, the task of marshaling and selling the assets of the estate began. With respect to the club assets, the estate hired Alan M. Kapson, Mr. Marchello's New York attorney since 1993, as its representative. Mr. Kapson advised the estate that it could "evict" the current tenants of the club because the August 15, 1996 Operating Agreement had expired. Consequently, Mr. Aslan and his management companies no longer had a contractual right to continue running the VIP Club using the assets and lease owned by Dezer Entertainment. Mr. Fleming, as executor, authorized Mr. Kapson to take control of the day-to-day operations of the club on behalf of Mr. Marchello's estate, until the club assets could be sold. Mr. Fleming quickly learned that the club was suffering significant financial strain because of the illegal activities of the mob and Mr. Vargo. Mr. Kapson advised him that it appeared that money was being taken, and the club might not be able to pay its bills, including taxes. The illegal activities jeopardized the estate's ability to sell the club assets. At Mr. Kapson's advice, Mr. Fleming also demanded that Mr. Aslan remove Mr. Vargo from the club and that he fully cooperate with Mr. Kapson pending the sale of the club assets. Because Mr. Aslan was cooperative with the estate, he was permitted to work at the club until its assets were sold and the lease for the premises was assigned.

33. The mob sought to ensure that their control and domination of the club would continue after Mr. Marchello's estate sold the assets of the club. Mob associates made threatening phone calls to Mr. Fleming and told him that he was not allowed to assign the lease for the premises or sell the assets to anyone but them. Mr. Fleming was afraid to deal with the sale of the club and

just wanted the whole transaction over with. The estate's representative, Mr. Kapson, was also threatened in late July 2002 or early August 2002. In fact, Mr. Scala's associate, Mr. Sassano, threatened Mr. Kapson's life one night when he was at the club. Mr. Sassano pressed Mr. Kapson's head against the bar, and screamed at him that: "You don't own this bar. Sal and I own this bar." Mr. Kapson resigned as the estate's representative that same night.

34. Ultimately, however, a sale of the club's assets was negotiated. This took place on August 26, 2002 when Dezer Entertainment entered into an Assignment and Assumption of Lease, along with an Agreement of Purchase and Sale of Assets. On behalf of Dezer Entertainment, Mr. Fleming, as executor of the estate of Frank Marchello, executed both the assignment and the agreement. The purchaser in this transaction was West 20th Enterprises Corp., which thereafter owned and operated the club. Review of the purchase and sale agreement indicates a sale price of $1,505,461.42 for the club's assets. In this transaction, Dezer Entertainment sold only things it could sell: the lease for the premises and the physical assets located at the premises.

35. Dezer Entertainment Concepts, Inc.'s name was changed to Hillsborough Corp. (Hillsborough) on December 6, 2002, by Certificate of Amendment of the Certificate of Incorporation of Dezer Entertainment Concepts, Inc., under section 805 of the Business Corporation Law.

36. As noted above, Mr. Aslan set up three companies to manage the day-to-day operations of the VIP Club. Two of the corporations, 20/20 and Prestige were registered sales tax vendors that filed sales tax returns but did not pay the proper amount of tax due on such returns. The third, Club V.I.P. was not a registered vendor and did not file any sales tax returns for the period December 1, 1995 through August 31, 2002.

37. The Division began a sales and use tax field audit of 20/20 on May 1, 2002. An auditor, Nathan Finkelshteyn, and his team leader, Michael Macaluso, conducted a field audit appointment of 20/20 at the club premises on July 18, 2002. As a result of information supplied by Mr. Aslan at that field audit appointment, the sales and use tax audit of 20/20 was transferred to Alton Plunkett, the auditor assigned by the Division to conduct the sales and use tax field audit of Prestige and Club V.I.P.

38. On August 15, 2002, while beginning his field audit of Prestige and 20/20, Mr. Plunkett delivered a handwritten request for the books and records of Club V.I.P. to Mr. Aslan, requesting the books and records for the period December 1, 1995 through May 31, 2002. On August 16, 2002, Mr. Plunkett mailed an appointment letter to Club V.I.P. scheduling a field audit appointment for August 23, 2002.

39. On August 21, 2002, Mr. Plunkett called Mr. Aslan to confirm the August 23, 2002 appointment but was unable to reach him. The auditor left a message asking Mr. Aslan to return his call. On September 18, 2002, the auditor again attempted to contact Mr. Aslan by telephone to schedule an audit appointment but was unable to reach him. The individual who answered the telephone at the club advised Mr. Plunkett that Mr. Aslan no longer worked there and that the business was under new management. That person provided Mr. Plunkett with a telephone number for Mr. Aslan. Subsequently, on September 23, 2002, Mr. Plunkett was able to reach Mr. Aslan at the new telephone number. During that conversation, Mr. Aslan confirmed that the club was in fact sold but stated that he was not involved in the sale. Mr. Aslan also requested additional time to make the books and records of Club V.I.P. available for audit.

40. On November 15, 2002, the auditor received a letter from Mr. Aslan, stating, among other things, that the VIP Club was owned by Dezer Entertainment, which company held both

the lease for the premises and the liquor license. The letter further stated that Mr. Marchello had died on January 29, 2002, that ownership of Dezer Entertainment and thereby the club was passed on to Mr. Marchello's wife, Annabelle, and that Mr. Bill Fleming was named the executor of Mr. Marchello's estate. In this letter, Mr. Aslan also stated that, on August 26, 2002, Mr. Marchello's executor informed him that the club was sold and that he should turn over its operation to the new owners, Anthony Capeci and his associates. Mr. Aslan further stated in his letter that he found out that West 20th Enterprises Corp. was the new corporate entity operating the club.

41. After receiving the November 15, 2002 letter, the Division's auditor did not make any attempt to contact Mr. Fleming. Even though he was in contact with Mr. Aslan at the time, he did not ask Mr. Aslan for Mr. Fleming's contact information, such as a phone number (which Mr. Aslan had available). The auditor also did not try to locate Mr. Fleming through the phone book or other means. Based upon the November 15, 2002 letter, the auditor assumed Mr. Aslan worked for Mr. Fleming and would tell him about the sales tax audit of Club V.I.P. The auditor did not accept the November 15th letter as adequate evidence of Mr. Marchello's death or Mr. Fleming's appointment as executor of Mr. Marchello's estate. However, the auditor never requested or obtained copies of Mr. Marchello's death certificate, his last will and testament, the letters testamentary for his estate, or the estate tax return that was filed by his estate.

42. The auditor sent Club V.I.P. a letter dated March 19, 2003 in which he advised the corporation that all books and records pertaining to the sales and use tax liability for the period December 1, 1995 through August 31, 2002 should be available at the appointment scheduled for April 9, 2003 at Club V.I.P.'s offices. A Records Requested List was attached to the letter.

43. An entry for April 9, 2003 in Club V.I.P.'s Tax Field Audit Record (audit record) indicates that at a Metropolitan District Office conference (office conference), Mr. Aslan provided the auditor and his team leader, Mr. Macaluso, with copies of Club V.I.P.'s federal income tax returns for the years 1996, 1997 and 1998. During that office conference, Mr. Aslan requested additional time to provide the remainder of the corporation's books and records. An audit record entry for October 9, 2003 indicates that, during a telephone call initiated by the auditor, Mr. Aslan again requested additional time to provide the corporation's books and records.

44. Because no other books and records for Club V.I.P. were provided, the auditor used the corporation's federal income tax returns for the years 1996, 1997 and 1998 to determine its sales and use tax liability for the period in issue.

45. For the period February 1996 through December 1996, Club V.I.P. reported $3,761,543.00 in gross sales on its 1996 federal income tax return. The corporation reported gross sales of $8,295,273.00 and $6,892,465.00, respectively, for the years 1997 and 1998, respectively, on the federal income tax returns filed for such years. Because there was no information provided for the remainder of the audit period, the auditor computed average annual gross sales for the years 1997 and 1998 of $7,593,869.00 and determined that this amount was the gross sales for each of the years 1999, 2000 and 2001. For the months of January through August 2002, the auditor prorated the average annual gross sales and determined that sales for the eight-month period were $5,062,579.00. Then he added the gross sales reported for the years 1996 through 1998 and the gross sales calculated for the remainder of the audit period, and determined total gross sales of $46,793,467.00 for the period December 1, 1995 through August 31, 2002. Since no evidence was provided that any sales were exempt, the auditor deemed all

receipts taxable. After multiplying taxable sales of $46,793,467.00 by the applicable tax rate, the auditor determined tax due from sales in the amount of $3,860,461.11 for the period in issue.

46. The auditor also used available information from the corporation's federal income tax returns for the years 1996, 1997 and 1998 to determine use tax due on expense purchases. As with sales, the returns provided expense information for the period February 1996 through December 1998. The auditor reviewed these expense purchases and selected taxable expense items including professional and consulting fees, office supplies, janitorial, equipment rental, and bath and dressing room supplies, and determined taxable expenses of $297,141.00, $1,187,359.00 and $885,935.00, respectively, for the years 1996, 1997 and 1998. The auditor computed average taxable expense purchases for the years 1997 and 1998 of $1,036,647.00, and projected that average for taxable expense purchases for each of the years 1999 through 2001. Just as was done for sales, the auditor prorated average taxable expense purchases for the months of January through August 2002 and determined taxable expense purchases for the eight-month period of $691,098.00. Because Club V.I.P. provided no proof that it paid tax on its taxable expense purchases for the period at issue, the auditor determined that use tax was due on these expense purchases. Accordingly, the auditor determined total taxable expense purchases of $6,171,474.00 for the period December 1, 1995 through August 31, 2002, and after applying the applicable tax rate to such taxable expenses, determined use tax due in the amount of $509,146.58 on expense purchases for the period in issue.

47. The auditor combined $3,860,461.11, the tax due on additional taxable sales of $46,793,467.00, with $509,146.58, the use tax due on expense purchases of $6,171,474.00, and determined total sales and use tax due on audit of $4,369,607.69. These amounts were reflected in a Statement of Proposed Audit Change for Sales and Use Tax, which was issued to Club V.I.P.

in April 2004. The Statement of Proposed Audit Change also asserted interest due, along with penalties in the amount of $1,309,099.33. The auditor assessed "regular penalties" because "penalty is normally assessed on these cases."

48. The audit conclusions and copies of the audit work papers were provided to Mr. Aslan on April 14, 2004 at an office conference. During that meeting, Mr. Aslan requested additional time to review the audit work papers and to obtain additional records. Review of the audit record indicates that no additional records were provided.

49. During the course of the Division's audit of Club V.I.P., the United States government seized the VIP Club's books and records in connection with its investigation and prosecution of Messrs. Scala and Sassano. These books and records remain in the custody of the federal government.

50. Subsequently, the Division issued to Club V.I.P. a Notice of Determination, Notice Number L024422061, assessing additional tax in the amount of $4,369,607.69, plus penalties and interest, for the period December 1, 1995 through August 31, 2002. The record does not include a copy of the Notice of Determination issued to Club V.I.P. The record also does not disclose whether Club V.I.P. protested the Notice of Determination against it.

51. A review of the audit work papers indicates that the auditor concluded his audit of Club V.I.P., on August 23, 2004, after spending a total of 62 hours on the audit of the corporation. At that time, the auditor made a determination that Steve Aslan and Hillsborough Corp. should be issued notices of determination on the grounds that they were liable as responsible persons for the additional taxes, interest and penalties that were asserted against Club V.I.P. Responsible officer assessments were not issued to Mr. Marchello or his estate at the time the auditor closed his audit of Club V.I.P.

52. At the hearing, the auditor conceded that he did not, at any time during the course of his audit, ever request (much less receive) a responsible person questionnaire for Club V.I.P. Nor did he request or receive any other information which showed: (i) that Mr. Marchello was a shareholder, employee, officer, or director of Club V.I.P.; (ii) that Mr. Marchello had the authority to sign, or ever actually signed, checks on behalf of the company; (iii) that Mr. Marchello signed any consents to extend the statute of limitations for asserting additional sales or use tax against the company; (iv) that Mr. Marchello had the authority to hire and fire employees or that he ever actually hired or fired an employee; (v) that Mr. Marchello had the authority to direct, or ever actually directed, the company as to the payment of its creditors; or (vi) that Mr. Marchello had the authority to negotiate, or ever actually negotiated, loans on behalf of the company. The auditor also conceded that he never spoke with the executor of Mr. Marchello's estate, William Fleming, or his widow, Annabelle, regarding Mr. Marchello's involvement, if any, in the company.

53. As noted above, on February 10, 2005, the Division issued a Notice of Determination to Mr. Marchello, which asserted that he was personally liable, as a responsible person, for the additional sales and use taxes, interest and penalties that had been asserted against Club V.I.P. At the hearing, the auditor explained that he based his determination that Mr. Marchello was a responsible person solely upon his review of the August 15, 1996 Operating Agreement. However, the auditor never explained what it was about the Operating Agreement that led to his conclusion regarding Mr. Marchello's alleged responsible officer status.

54. At some point during the audit of Club V.I.P., the auditor received a copy of the Operating Agreement. However, he made no notation of receipt of this document in his audit record because at the time he did not think it was an important document.

55. The Notice of Determination was issued and addressed to Mr. Marchello at PO Box, Basking Ridge, New Jersey. The PO Box had been used by Mr. Marchello in connection with his businesses. Mr. Fleming, the estate's executor, conceded that he received the Notice of Determination issued to Mr. Marchello. At the time the Notice of Determination was issued to Mr. Marchello, Mr. Fleming's address was Toms River, New Jersey. After he became executor of Mr. Marchello's estate, Mr. Fleming never initiated any contact with the Division before receiving the Notice of Determination issued to Mr. Marchello because he had no idea there was a tax issue. Subsequently, that Notice of Determination was protested at a Bureau of Conciliation and Mediation Services conference. By Conciliation Order dated September 8, 2006, the conferee sustained the statutory notice.

56. On December 4, 2006, petitioner timely filed the petition in this matter. On February 21, 2007, the Division issued an answer to the petition. The Division's answer affirmatively states that Mr. Marchello was being deemed a responsible person of Club V.I.P. of N.Y. The answer did not notify petitioner that the Division would seek to hold him liable as a responsible person of Hillsborough.

57. During the hearing in this matter, the Division's auditor was asked to provide testimony regarding the taxability of exotic dance transactions, such as those that Club V.I.P. had entered into during the audit period. The Division's auditor testified that, in his 25 years as an auditor, he has conducted "quite a few" audits of establishments similar to the VIP Club. Yet, when he was asked about his prior audits of similar gentlemen's clubs, the auditor repeatedly claimed that he was unable to recall what he had determined regarding the taxability of exotic dances and that he was unable to compare the transactions entered into by Club V.I.P. to those of taxpayers he has previously audited. The auditor specifically emphasized that it would be

inappropriate for him to rely upon his experience and determinations in prior audits of similar taxpayers to make a determination as to the taxability of the transactions at issue in the audit of Club V.I.P. The audit record entry for February 11, 2003 indicates that the auditor "reviewed case and case folders of similar audits," and spent a total of five hours on such review.

58. The auditor ultimately provided testimony regarding his determinations in prior audits as to the taxability of exotic dances. The auditor testified that the sale of an exotic dance would be subject to sales tax only if it was sold to the customer as part of a package that also included the sale of taxable food or drink. The auditor testified that the sale of a dance alone would not be taxable. Moreover, the auditor testified that it does not matter whether the dance is performed out in the open of the club or in a private room. The auditor also noted that a separate fee charged for access to a private room would be subject to sales tax as an admission charge. The auditor emphasized, however, that the sale of a dance to be performed within the private room remains nontaxable even if a separate admission fee is charged.

59. The record includes Mr. Plunkett's audit work papers for 20/20 and Prestige. A review of 20/20's audit work papers indicates that Mr. Plunkett described the nature of its business as a "restaurant and bar with entertainment," and after charging 57½ hours to the audit, determined additional tax due in the amount of $140,459.73, plus interest and penalties for the period December 1, 1995 through August 31, 2002. A review of Prestige's audit work papers indicates that Mr. Plunkett described the nature of its business as a "restaurant and bar with entertainment," and after charging 79 hours to the audit, determined additional tax due in the amount of $1,244,054.18, plus interest and penalties for the period December 1, 1995 through November 30, 2000.

60. The record includes copies of the New York State Liquor Authority files for Dezer Entertainment, which the Division obtained in preparation for the hearing in this matter. A review of these files indicates that Mr. Marchello submitted documents to the State Liquor Authority identifying himself as owner of the club and changing the club's trade name to VIP Club. Further review of these files indicates that Mr. Marchello was the principal for the liquor license used by the VIP Club.

61. The issues addressed at the hearing may be generally summarized as follows: the audit of Club V.I.P. of New York, Inc. and the taxability of its receipts; the Division's determination that Frank Marchello was a person responsible for collecting and paying over the sales taxes allegedly due from Club V.I.P.; and the propriety of issuing the Notice of Determination to Frank Marchello, rather than to his estate. At the hearing, the Division did not raise the issue that Hillsborough was the vendor responsible for the collection of New York State taxes and that Frank Marchello, as president of Hillsborough, was a responsible person.

62. At the conclusion of the hearing, the record closed. Petitioner's brief was timely filed on March 27, 2008. The Division filed its brief on July 8, 2008. In that brief, the Division argued, among other things, that Hillsborough was the vendor responsible for the remission of sales taxes owed by Club V.I.P., and that petitioner was a responsible person of Hillsborough. By notice of motion, dated August 20, 2008, petitioner moved for an order reopening the record and admitting additional evidence, and granting summary determination in its favor. In its motion to reopen the record, petitioner contended that the record should be reopened for the admission of additional evidence necessary for it to fully and adequately respond to the new legal theory raised in the Division's brief. Specifically, petitioner requested that the following documents be admitted into evidence: (i) a copy of an Audit Verification Letter issued on July 3,

2008 by the sales tax section of the Division's Metropolitan District Office to Hillsborough for the period December 1, 1995 through August 31, 2002 (Audit Verification Letter); and (ii) a copy of a No Change Letter issued on July 3, 2008 by the sales tax section of the Division's Metropolitan District Office to Hillsborough for the period December 1, 1995 through August 31, 2002 (No Change Letter). The Division did not file a response to petitioner's motion to reopen the record and admit additional documents.

63. By order dated January 29, 2009, petitioner's motion for summary determination was denied as having been filed beyond the time allowed in CPLR 3212(a). Petitioner's motion to reopen the record was, however, granted. As a result, both the Audit Verification Letter and the No Change Letter were admitted into evidence. The Audit Verification Letter confirms that the Division conducted and completed a sales and use tax audit of Hillsborough for the periods at issue in this proceeding. The No Change Letter states, among other things: "We have completed our tax audit for the period(s) listed above and have concluded that no additional tax is due." Except for the Audit Verification Letter and the No Change Letter, no other evidence was permitted into the record. Following the January 29, 2009 order, the record again was closed.

64. Petitioner submitted proposed findings of fact numbered 1 through 49. The following proposed findings of fact are accepted and have been substantially incorporated into the Findings of Fact herein: 2 through 6, 8, 11 through 13, 15, 16, 19, 21 through 27, 32, 35, and 44 through 49. The following proposed findings of fact are unsupported by the record and are therefore rejected: 7, 9, 10, 14, 29, 34, 36, 41, and 43. The following proposed findings of fact are rejected because they contain lengthy excerpts from the transcript: 18, 28 and 37. The following proposed findings of fact are in the nature of a conclusion and are therefore rejected: 17, 20, 30, 31, 33, 38, 39, 40 and 42. Proposed finding of fact 1 is rejected as unnecessary for purposes of

this determination. In ruling on petitioner's proposed findings of fact, if any part of a proposed finding is unsupported by the record the proposed finding has been rejected in its entirety.

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) states in pertinent part that:

> A notice of determination shall be mailed by certified or registered mail to the person or persons liable for the collection or payment of the tax at his last known address in or out of this state. If such person or persons is deceased or under a legal disability, a notice of determination may be mailed to his last known address in or out of this state, unless the department has received notice of the existence of a fiduciary relationship with respect to the taxpayer.

B. Petitioner maintains that the Notice of Determination at issue in this proceeding is jurisdictionally defective because it was not issued to the estate of Frank Marchello. It argues that the Division received notice that William Fleming was the executor of the estate of Frank Marchello in Mr. Aslan's November 15, 2002 letter to the auditor, and therefore, the Notice of Determination should have been issued to the estate of Frank Marchello, William Fleming, executor, in accordance with Tax Law § 1138(a)(1). Petitioner also argues that any liabilities asserted against a deceased taxpayer must be assessed against his estate.

Petitioner's arguments are without merit. The November 15, 2002 letter merely identified Mr. Fleming as the named executor of the estate of Frank Marchello, it did not provide an address for Mr. Fleming or any supporting proof of Mr. Fleming's appointment as executor, such as letters testamentary, letters of administration or an order of appointment as executor. As such, the Division did not have notice that the estate of Frank Marchello had an appointed fiduciary. In addition, there is no evidence that the estate filed any returns or other notices with the Division that would have put it on notice of Mr. Fleming's appointment as executor and his fiduciary relationship with the late Frank Marchello. Given the absence of any notice of a fiduciary

relationship, the Division's issuance of the Notice of Determination to Frank Marchello at his last known address was proper. Moreover, it is not erroneous to issue a Notice of Determination in the name used by the taxpayer during the period of assessment (***Matter of Orvis***, Tax Appeals Tribunal, January 23, 1993, ***confirmed***, 86 NY2d 165, 630 NYS2d 680 [1995], ***cert denied***, 516 US 989 [1995]). Absent any harm or prejudice as a result of any error in the notice, the notice will not be invalidated (***Matter of Orvis***; ***Matter of Agosto v. Tax Commn***., 68 NY2d 891, 508 NYS2d 934 [1986]; ***Matter of A & J Parking Corp***., Tax Appeals Tribunal, April 9, 1992; ***Matter of Tops***, Tax Appeals Tribunal, November 22, 1989). Although the Notice of Determination was issued to Frank Marchello individually rather than to his estate, it did reach Mr. Fleming, executor of the estate of Frank Marchello, the person who would be responsible for paying any assessment that may be upheld. There is no evidence that Mr. Fleming was confused, misunderstood the basis for the assessment, or was unaware of his duty to respond. Indeed, the Notice of Determination was formally protested by Mr. Fleming, executor of the estate of Frank Marchello. There is no evidence that petitioner was prejudiced by the mistake on the notice; therefore, the Notice of Determination dated February 10, 2005 is valid.

C. Petitioner asserts that the Notice of Determination issued to Mr. Marchello should be cancelled because there is no underlying corporate assessment in this case from which his responsible person assessment can be derived. Since the Division failed to put into evidence a Notice of Determination issued to Club V.I.P., petitioner argues that it must be concluded that there is no liability against the corporation, and therefore, the Notice of Determination issued to Mr. Marchello should be cancelled. In support of its position, petitioner relies upon ***Matter of Mackiewicz*** (Tax Appeals Tribunal, June 7, 2007).

Petitioner's argument is without merit. The record clearly establishes that a Notice of Determination was issued to Club V.I.P. and that such notice was not challenged by petitioner. Therefore, the Division was not required to produce the Notice of Determination issued to Club V.I.P. at the hearing in this matter. Petitioner's reliance on ***Matter of Mackiewicz*** is misplaced. ***Mackiewicz*** stands for the proposition that any adjustments made to a corporate assessment must flow through to an assessment issued to a responsible officer because the officer's liability is derivative of the corporate assessment. Since there is no evidence that Club V.I.P. challenged the Notice of Determination issued against it, or that any adjustments were made to the corporate assessment, the Notice of Determination issued to Mr. Marchello cannot be cancelled or adjusted (***Matter of Mackiewicz***).

D. The next issue presented for resolution is whether the Notice of Determination issued to Frank Marchello lacked a rational basis. Petitioner argues that the record in this matter demonstrates that the auditor's decision to assess Mr. Marchello as a responsible person of Club V.I.P. was wholly capricious because he did not have any grounds at all, at the time he issued the assessment, to be able to reasonably determine that Mr. Marchello was a responsible person. It claims the record clearly shows that the auditor did not request or obtain a responsible officer questionnaire for Club V.I.P. that suggested Mr. Marchello was a responsible officer of the company, that the auditor did not contact either the executor of Mr. Marchello's estate or his widow to obtain information regarding the extent to which Mr. Marchello was involved, if at all, in the affairs of Club V.I.P., and that at the time the corporation's audit was closed, the auditor made a determination to assess only Mr. Aslan and Hillsborough. Petitioner further argues that the Operating Agreement that the Division submitted at the hearing was an after-the-fact attempt

to justify the auditor's prior audit determination, and as such, is insufficient evidence to establish a rational basis for the responsible officer assessment at issue in this matter.

E. The record shows that the Division's decision to assess Frank Marchello as a responsible person of Club V.I.P. had a rational basis. The auditor testified that he received the Operating Agreement that Mr. Marchello entered into in August 1996 with Mr. Aslan and his management companies (i.e., 20/20, Prestige and Club V.I.P.), during the course of Club V.I.P.'s audit. He further testified that his review of the Operating Agreement was the basis for his conclusion that Mr. Marchello was a responsible person for the collection and payment of sales taxes of Club V.I.P. While the auditor did not testify about particular paragraphs of the Operating Agreement upon which he relied in reaching his conclusion that Mr. Marchello was a responsible person, the terms of the Operating Agreement clearly show that Mr. Aslan and his management companies (i.e., 20/20, Prestige and Club V.I.P.) were employed by Mr. Marchello and Dezer Entertainment, and that an agency relationship existed.

F. "An agency is a fiduciary relationship which results from a manifestation of consent by one person to another that the other shall act on his behalf and subject to his central control and the consent by the other to act" (***Matter of Custom Management v. New York State Tax Commission***, 148 AD2d 919, 539 NYS2d 550, 551 [1989]). "It is a relationship whereby 'one retains a degree of direction and control over another' [citation omitted]" (***Meese v. Miller,*** 79 AD2d 237, 436 NYS2d 496, 499 [1981]). An agent is a person who acts for or in the place of the principal by authority from the principal. The agent is one who, by the authority of another, undertakes to transact some business or manage some affairs on account of such other. "He is a substitute or deputy appointed by his principal, with power to do the things which the principal

may or can do, and primarily to bring about business relations between the principal and third persons. It is generally understood that a 'manager' is an agent" (2 NY Jur 2d, Agency § 1).

The Operating Agreement was executed by Mr. Marchello in his individual capacity, and as president of "A" Street and Dezer Entertainment, and by Mr. Aslan, in his individual capacity, and as president of Club V.I.P., 20/20 and Prestige. This operating agreement required Mr. Aslan to manage the day-to-day operations of the VIP Club, to pay all of the club's expenses in connection with its management (including the weekly payment of $2,884.62 to Mr. Marchello), and after the payment of all expenses, to pay any excess profit to Mr. Marchello. The agreement also required Mr. Aslan to be available for meetings and consultations with Mr. Marchello and to make the club's books and records available to Mr. Marchello upon request. Petitioner does not dispute that the Operating Agreement governed the relationship between Mr. Marchello and Mr. Aslan. Mr. Aslan credibly testified about his management of the VIP Club during the period in issue. When the VIP Club opened for business on February 19, 1996, Mr. Aslan and his management companies, along with Mr. Vargo, operated and managed the club pursuant to an oral agreement that they had previously reached with Mr. Marchello, which was formalized in the August 15, 1996 Operating Agreement. When the club first opened, Mr. Aslan met with Mr. Marchello regularly to discuss the operation of the club, and Mr. Marchello provided suggestions regarding the club at those meeting. While Mr. Aslan acknowledged that Mr. Marchello had authority to dictate the daily operation of the club, he stated that Mr. Marchello never exercised that authority because he was satisfied with the progress Mr. Aslan was making. Over time, Mr. Marchello's meetings with Mr. Aslan became less frequent. Mr. Aslan made weekly payments of $2,884.62 to Mr. Marchello, and at times, Mr. Aslan also made additional payments to Mr. Marchello. Although the Operating Agreement expired in August 2001, Mr. Aslan and his

management companies continued to manage the VIP Club. During the last year of Mr. Marchello's life, he rarely met with Mr. Aslan. Based upon the foregoing it is clear that Mr. Aslan and the three management companies, i.e., Club V.I.P., 20/20 and Prestige, that he owned and operated, were agents of Mr. Marchello and Dezer Entertainment. It is a fundamental rule that the principal is bound by, and liable for the acts which his agent does with or within the actual or apparent authority of the principal, and within the scope of his employment (3 NY Jur 2d, Agency § 239). Mr. Marchello passed away on January 29, 2002, at which time his agency relationship with Mr. Aslan and Club V.I.P. ended (***see*** 2 NY Jur 2d, Agency § 44), and the ownership of the VIP Club passed in accordance with the terms of Mr. Marchello's last will and testament. It is noted that the Division determined that Mr. Marchello was personally liable for Club V.I.P.'s sales tax obligations for the period December 1, 1995 through August 31, 2002. The Division clearly had a rational basis to conclude that Frank Marchello was a responsible person of Club V.I.P. for the period December 1, 1995 through January 29, 2002. However, there is no rational basis for an assessment against Mr. Marchello for the remainder of the audit period, i.e., January 30, 2002 through August 31, 2002, and therefore, that portion of the Notice of Determination must be cancelled.

G. Tax Law § 1133(a) imposes upon any person required to collect the tax imposed by Article 28 of the Tax Law personal liability for the tax imposed, collected or required to be collected. Tax Law § 1131(1) defines "person required to collect any tax imposed by [Article 28]" as follows:

> [E]very vendor of tangible personal property or services; every recipient of amusement charges; and every operator of a hotel. Said terms shall also include any officer, director or employee of a corporation or of a dissolved corporation, any employee of a partnership, any employee or manager of a limited liability company, or any employee of an individual proprietorship who as such officer,

> director, employee or manager is under a duty to act for such corporation, partnership, limited liability company or individual proprietorship in complying with any requirement of this article; and any member of a partnership or limited liability company. . . .

H. The determination of whether an individual is a person under a duty to act for a corporation is based upon a close examination of the particular facts of the case (***see Cohen v. State Tax Commn***, 128 AD2d 1022, 513 NYS2d 564 [1987]; ***Stacy v. State***, 82 Misc 2d 181, 368 NYS2d 448 [1975]; ***Chevlowe v. Koerner***, 95 Misc 2d 388, 407 NYS2d 427, 429 [1978]; ***Matter of Hall***, Tax Appeals Tribunal, March 22, 1990, ***confirmed*** 176 AD2d 1006, 574 NYS2d 862 [1991]; ***Matter of Martin***, Tax Appeals Tribunal, July 20, 1989, ***confirmed*** 162 AD2d 890, 558 NYS2d 239 [1990]; ***Matter of Autex Corp***., Tax Appeals Tribunal, November 23, 1988). Factors to be considered, as set forth in the Commissioner's regulations, include whether the person was authorized to sign the corporate tax return, was responsible for managing or maintaining the corporate books or was permitted to generally manage the corporation (20 NYCRR 526.11[b][2]). As summarized in ***Matter of Constantino*** (Tax Appeals Tribunal, September 27, 1990):

> [t]he question to be resolved in any particular case is whether the individual had or could have had sufficient authority and control over the affairs of the corporation to be considered a responsible officer or employee. The case law and the decisions of this Tribunal have identified a variety of factors as indicia of responsibility: the individual's status as an officer, director, or shareholder; authorization to write checks on behalf of the corporation; the individual's knowledge of and control over the financial affairs of the corporation; authorization to hire and fire employees; whether the individual signed tax returns for the corporation; the individual's economic interest in the corporation (***Cohen v. State Tax Commn***, ***supra***, 513 NYS2d 565; ***Blodnick v. State Tax Commn***., 124 AD2d 437, 507 NYS2d 536, 538, ***appeal dismissed*** 69 NY2d 822, 513 NYS2d 1027; ***Vogel v. New York State Dept. of Taxation & Fin., supra***, 413 NYS2d at 865; ***Chevlowe v. Koerner***, ***supra***, 407 NYS2d at 429; ***Matter of William D. Barton*** [Tax Appeals Tribunal, July 20, 1989]; ***Matter of William F. Martin***, ***supra***; ***Matter of Autex, supra***).

I. Summarized in terms of a general proposition, the issue to be resolved is whether petitioner had, or could have had, sufficient authority and control over the affairs of the corporation to be considered a person under a duty to collect and remit the unpaid taxes in question (***Matter of Constantino; Matter of Chin***, Tax Appeals Tribunal, December 20, 1990). In order to prevail, "petitioner was required to establish by clear and convincing evidence that he was not an officer having a duty to act on behalf of the corporation, i.e., that he lacked the necessary authority or he had the necessary authority, but he was thwarted by others in carrying out his corporate duties through no fault of his own (citations omitted)" (***Matter of Goodfriend***, Tax Appeals Tribunal, January 15, 1998).

J. Upon review of the entire record, it is clear that petitioner has met its burden of proving that Frank Marchello was not properly held responsible for the sales and use tax obligations in issue. The record shows that through its use of extortion and racketeering activities, organized crime controlled the operations of the VIP Club during the period December 1, 1995 through August 31, 2002. Through intimidation and force, Salvatore Scala, a "captain" in the Gambino crime family, and his mob associates "bled the club dry." They demanded and received protection payments from the club, forced the club to keep mob associates on the payroll as "security" for the club, and ordered the club to let mob associates and friends run up large food and bar tabs that were never paid. As the club's revenues increased, Mr. Scala and his mob associates demanded and received larger protection payments. Mr. Aslan credibly testified that he complied with the demands made by Mr. Scala and his mob associates because he felt intimidated and feared their use of physical violence. Shortly before the end of the audit period, Alan Kapson, a New York attorney retained by Mr. Marchello's estate to oversee the day-to-day operations of the club until it could be sold, resigned within hours of being physically threatened

by Thomas Sassano, a "soldier" in the Gambino organized crime family, in the club. Mob associates also made threatening telephone calls to Mr. Fleming, executor of Mr. Marchello's estate, and told him that he was not allowed to assign the lease for the premises or sell the assets to anyone but them. Mr. Fleming credibly testified that he was afraid to deal with the sale of the club and just wanted the transaction completed. In March 2007, Messrs. Scala and Sassano were convicted in the United States District Court for the Southern District of New York on charges connected to their extortion of the VIP Club. The influence of organized crime over the VIP Club was not limited to the activities of the Gambino crime family. Mr. Vargo was also connected to the Genovese crime family, which demanded weekly payments from the club. Mr. Vargo collected the payments on behalf of the Genovese crime family and routinely used physical violence against Mr. Aslan or the threat thereof to ensure that the payments were made. Mr. Vargo also had a serious drug and gambling problem that resulted in his becoming indebted to a host of bookies connected to a variety of organized crime families. To ensure that his bookies were paid, Mr. Vargo used violence and the threat of violence against Mr. Aslan. Over the course of the audit period, the VIP Club was forced to pay out approximately $4 million in extortion and other payments. The resulting financial impact was devastating and created major cash flow problems for the management companies. The financial burden placed upon Club V.I.P. was far greater than the financial burdens placed upon the other two management companies because approximately two-thirds of the club's revenue was generated by Club V.I.P.'s sales of dance dollars during the audit period. Mr. Aslan credibly testified that the extortion and racketeering activities would have made it impossible for Club V.I.P. to satisfy its sales tax obligations even if it had determined that it was required to collect tax on its sales of dance dollars. Indeed, the extortion and racketeering made it impossible for either 20/20 or

Prestige to satisfy their respective sales and use tax obligations to New York State. Clearly, Mr. Aslan and his management companies, Club V.I.P., 20/20 and Prestige, were unable to actually control the affairs of the VIP Club. As concluded above, Mr. Aslan and Club V.I.P., were employed by and acted as agents for Mr. Marchello, the owner of the VIP Club, during the period December 1, 1995 through January 29, 2002. "It is the accepted rule that the act of an agent within the scope of his authority or employment is in legal effect the act of the principal, and the latter is entitled to all of the advantages flowing therefrom" (3 NY Jur 2d, Agency § 270). Given the extent to which organized crime controlled the operations of the VIP Club during the audit period, it was impossible for either Mr. Aslan or Mr. Marchello to exercise any actual decision-making or other authority over Club V.I.P. Accordingly, it is concluded that Frank Marchello is not responsible for the collection and payment for sales tax pursuant to Tax Law §§ 1131 and 1133.

K. Issues V and VI are rendered moot.

L. The petition of Frank A. Marchello (Deceased) is granted, and the Notice of Determination dated February 10, 2005 is hereby cancelled.

DATED: Troy, New York
November 19, 2009

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE