

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
HAIR CLUB FOR MEN, LLC : DETERMINATION
for Revision of a Determination or Refund of Sales and : DTA NO. 822686
Use Taxes under Articles 28 & 29 of the Tax Law for the :
Period December 1, 2006 through February 28, 2007. :

Petitioner, Hair Club for Men, LLC, 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, 2006 through February 28, 2007.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 633 Third Avenue, New York, New York, on July 28, 2009, at 10:30 A.M. and continued until conclusion at 500 Federal Street, Troy, New York, on September 2, 2009 9:15 A.M., with all briefs due by February 24, 2010, which date began the six-month period for the issuance of this determination. Petitioner appeared by Morrison & Foerster, LLP (Paul H. Frankel, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUES

I. Whether the services provided by petitioner were hair restoration services and not one of the enumerated taxable services under the Tax Law for New York State purposes, or the sale of tangible personal property and the subsequent service and maintenance of that property.

II. Whether the tangible personal property that was transferred to clients was merely incidental to nonenumerated services provided and therefore not taxable.

FINDINGS OF FACT

At hearing held on July 28, 2009, the parties submitted an undated Stipulation of Facts with respect to procedural matters and petitioner's business activities, which has been incorporated into the facts below to the extent relevant.

1. Petitioner, Hair Club for Men, LLC (Hair Club), is a Delaware limited liability company with its headquarters and principal offices in Boca Raton, Florida. During the period December 1, 2006 through February 28, 2007 (the audit period) Hair Club maintained three business locations in New York State in Buffalo, New York City and Lake Success.

Petitioner was founded by Sy Sperling in 1976, but its predecessor, Hair Restoration Centers, was founded by Sy Sperling and his brother and did not provide hair transplantation services or other surgical procedures for hair restoration.

2. During the audit period, Hair Club was one of the largest providers of solutions for hair loss in men and women, offering a selection of processes including (i) hair transplantation; (ii) hair therapy; and (iii) a nonsurgical process known as Bio-Matrix. These three hair restoration solutions were offered at each of the three New York locations during the audit period.

3. Hair transplantation is a procedure performed by a physician that involves taking hair from a "donor area" at the back of the client's head and transplanting that hair to the thinning area. The hair therapy process involves the use of products containing minoxidil, which is designed to prevent further hair loss. The Bio-Matrix process is a nonsurgical process whereby new hair is added to the individual's own hair.

4. During the audit period, individuals who chose the Bio-Matrix procedure could elect to enter into a membership agreement pursuant to which he or she would receive the various services that came with that process. The membership agreement for females was called the

Solutions Client Service Program Membership Agreement and the membership for males was referred to as the Preferred Client Service Program Membership Agreement. There were no other substantive differences between the membership agreements. Each membership agreement was for an initial term of one year with automatic one-year renewals.

5. The membership agreements permitted individuals to select among several different service levels. During the audit period, a member could select among six different service levels, which were labeled bronze, silver, gold, diamond, platinum and presidential. A member's fee was based on which membership level was chosen. The service provided was all-inclusive, and there were no separate charges for any of the services.

6. The membership agreements used for the Bio-Matrix procedure expressly stated that "this is primarily an agreement for the performance of hair care services and not an agreement for the sale of property." Further, each agreement contained a representation by the client that recited that he or she "must" return the head of hair to Hair Club at each application service.

7. The agreements set forth four general services that members receive: application services; full services; chemical services; and shampoo and style services. The actual volume of the services received is determined by the service level chosen. The basic service level provided 3 applications while the presidential level provided 26 applications.

8. Hair club advertised on the internet and through infomercials on television. Interested individuals were directed to call Hair Club to schedule an initial confidential consultation at the closest facility to the caller. The initial consultation lasted between an hour and an hour and a half, during which time the individual met with a hair loss specialist, who was not a physician, and discussed his or her hair loss and what the person sought to accomplish. The specialist discussed the various causes of hair loss and physically examined the individual's scalp with a

videoscope, which magnified the scalp to reveal the hair follicles. The specialist and individual saw the healthy follicles, those that were empty and those that were beginning to close or fill with oil. Based on this analysis, the specialist assisted the individual in deciding which of Hair Club's services was most appropriate.

9. When it was decided that the Bio-Matrix process was the most appropriate solution for the individual, a consultation with a Hair Club stylist was arranged. The stylists were licensed cosmetologists with at least ten years experience at a high-end salon. Since people came to Hair Club seeking a new look or an improvement in their image, the stylist worked with the person to achieve the desired look. The stylist discussed the individual's goals and then, based on factors such as the shape of the person's head, the thickness, color and texture of the person's hair, the individual's lifestyle and the stylist's experience, the stylist and client developed the desired new look or image.

10. The stylist then took detailed measurements of the thinning area and took hair samples to match the hair with replacement hair of the same diameter, thickness, density, texture and color. With this information and sample, Hair Club prepared the new head of hair in four to six weeks, at which time the client returned for scalp and hair preparation and the new hair.

11. The new head of hair was comprised of human hair created to match the sample provided. The new hair had been woven into a fine matrix of crisscrossing, transparent fibers that was manufactured in accordance with the measurements taken to match the contour of the individual's scalp and then blended into the client's own hair.

12. Prior to blending and attaching the matrix to the client's hair and scalp, the stylist washed the client's head and scalp with a clarifying shampoo to remove debris, oils, and other hair product residue. A mud mask was then applied to exfoliate the scalp, purifying the scalp and

further removing any dead skin cells and oils. An enzyme cleaner was then applied to remove any sebum oils and fatty acids from the scalp. Finally, the stylist performed whatever chemical processes were necessary for coloring, perming, relaxing, highlighting, bleaching or streaking.

13. The next step was the application of an adhesive agent called Polyfuse to the scalp and hair. The matrix was placed on the scalp and the client's hair was cut and styled, blending the client's own hair with the newly added hair. The preparatory steps and actual blending of the new hair took between an hour and an hour and a half for men and between two and three hours for women. However, the total time, on average, that the stylist spent handling or working with the new hair was only about four or five minutes.

14. A member received new hair several times a year. The exact number of times depended on the service level selected. In addition, depending on the service level chosen, members returned to Hair Club facilities for styling, cuts and other services several times a year. The number of services allocated to each level was set out in the membership agreements. However, the agreements required that members return within four to eight weeks after an application to properly maintain the head of hair.

15. During the audit period, Hair Club did not sell wigs or toupees, and petitioner did not perform any services on wigs or toupees that individuals may have brought to a facility. Although Hair Club had previously sold "hair systems" or "toupees" that would be attached to a client's head through various methods like weaving or velcro, it no longer offered these services and did not offer them during the audit period.

16. Under the prior business model, petitioner offered a switch program whereby clients would purchase multiple hair systems and exchange them every six months or so for a new one. The older hair system would be refurbished by a skilled wig maker, known in the industry as a

ventilator, and then given back to the client at the next switch. When one of the hair systems was worn out, the client would purchase another. The client owned the hair system and paid separate charges for the repairs and all services performed on the client's own hair. An average hair system lasted about two years. The prior system lacked the technology available during the audit period, which permitted petitioner to work with clients to develop a new look or image tailored to their individual preferences.

17. In the mid-1990s, petitioner began a sea change of its business model, turning away from a focus on sales of hair systems or pieces and separate services connected with them. The introduction of Polyfuse and the finer, transparent matrix created the opportunity for changing the new hair more frequently and improving the look of the head of hair. Although there were membership programs in existence prior to the change in the business model, they were not all inclusive and, as mentioned above, clients were separately charged for the hair systems, repairs and styling services.

18. Under the new membership programs, like the one in effect during the audit period, there were no longer separate charges for the services or the hair. In fact, petitioner retained ownership of the hair and, under the terms of the agreement with clients, the client was obligated to return it to petitioner. By 2003, all clients were enrolled in the membership programs.

19. Petitioner's new business model provided more confidentiality for its members, providing private rooms for styling and shampooing, in contrast with the community shampoo bowls shared by all clients previously. Hair Club facilities were consciously located in professional office buildings with no exterior signage indicating the location of the facilities on the premises. Doors to the facilities use smoked glass for privacy, and the consultation and

styling rooms were designed to provide privacy and create a comfortable and relaxing atmosphere.

20. Petitioner's business model also changed in the emphasis placed on service to clients. Several management personnel who testified at the hearing stressed the importance of ensuring the satisfaction of clients with Hair Club's services, noting petitioner's willingness to open early, close late, travel to locations outside its facilities and generally doing whatever it needed to do to provide the highest quality services to its members. Clients were afforded the opportunity to utilize any of Hair Club's locations when their own location was not convenient.

21. To maintain the highest quality services, petitioner hired and trained individuals it believed could deliver the level of services expected from its clients. Hair loss specialists received six weeks of training upon being hired and then went to a regional training facility for two to three additional weeks before returning to the center where they would ultimately work permanently, receiving even more training from a regional trainer.

22. Hair stylists also received significant training, although petitioner required that they have at least 10 years experience at a high-end salon. The stylists trained for a week in their permanent facility and also attended training at a regional training center for an additional three to four weeks. Both the specialists and the stylists received substantial salaries commensurate with their skills, training and abilities.

23. Petitioner's web site noted that it offered the three hair loss treatments mentioned above, making it unique among "hair restoration" companies. It also refers to its facilities as "hair restoration centers," only 13 of which were equipped and staffed to perform hair transplants.

In the Form 10-K filed by Regis Corporation, petitioner's corporate parent, for the period ended June 30, 2007, Hair Club was referred to as a "provider of hair restoration services" offering a "comprehensive menu of hair restoration alternatives." Yet, when answering a frequently asked question on its web site, petitioner stated that hair restoration was "a surgical hair loss treatment procedure . . . intended to permanently replace hair"

24. The Division of Taxation (Division) conducted an audit of petitioner for the period June 1, 2004 through February 28, 2007. It was discovered that petitioner was not collecting tax on its Preferred Client Program membership agreement receipts for the period December 1, 2006 through February 28, 2007.¹ The only disagreed portion of the audit related to the preferred client program sales of the Bio-Matrix procedure for the quarter ended February 28, 2007. The Division noted that petitioner began treating these sales as nontaxable hair restoring services, which prior to December 1, 2006 were treated as taxable. The Division further noted that, consistent with this change, petitioner paid use tax on the purchase of all products used in the services provided under the preferred client program agreements. Petitioner was also paying local tax to New York City on these program sales because New York City specifically taxes hair restoring services pursuant to New York City Administrative Code § 11-2002(h).

25. The Division concluded that the initial installation of the hair in the Bio-Matrix process constituted the installation of tangible personal property and the styling services performed thereafter constituted the maintenance and servicing of said property, and therefore taxable pursuant to Tax Law § 1105(c)(3). The Division's determination was also based upon a memorandum sent to the auditor, dated April 22, 2008, in which Ms. Mary Frankowski, a tax

¹Additional tax was also determined to be due on capital purchases (\$6,350.18), expense purchases (\$16,996.54) and on tax collected but not remitted (\$8,517.00). Petitioner agreed to and paid the additional tax due in these areas.

technician III in the Field Audit Management-sales tax unit, advised her that, to Ms.

Frankowski's knowledge, hair restoration had not been defined in the case law, but based on her research and consultations with "legal," she believed it was considered a surgical procedure performed by a physician to transplant hair follicles. Because the Bio-Matrix procedure was not surgical, Ms. Frankowski did not believe it constituted hair restoration. In addition, she noted that an advisory opinion had found that a hairpiece would not qualify as an exempt medical prosthetic device when used for cosmetic purposes and not as a result of a medical problem.

26. The preferred client program sales were reviewed in detail for the quarter ended February 28, 2007 and resulted in additional tax due of \$106,448.00, which remains the amount in issue herein.

27. The Division issued petitioner a Statement of Proposed Audit Change for Sales and Use Tax, dated August 27, 2008, which set forth additional tax due for the quarter ended February 28, 2007 of \$106,448.00 plus interest. A Notice of Determination, dated October 31, 2008, was issued to petitioner and asserted additional tax of \$106,448.00, plus interest, for the quarter ended February 28, 2007.

SUMMARY OF THE PARTIES' POSITIONS

28. Petitioner argues that it is providing a nontaxable hair restoring service pursuant to its Bio-Matrix membership agreements. It notes that hair restoring services are not included in the enumerated services subject to tax in New York State. Petitioner concedes, and remits, sales tax to New York City, which specifically taxes the receipts from hair restoring, which is not rendered by a physician.

Petitioner notes that New York State has unsuccessfully attempted to enact legislation which would have permitted the taxation of receipts from hair restoring services. The provision,

included in the 2009-2010 executive budget, was virtually identical to New York City Administrative Code § 11-2002(h).

29. Petitioner maintains that the term hair restoring is not defined in the case law, the New York State Tax Law or in the New York City Administrative Code and that what is meant by that term and whether petitioner is performing hair restoring in its Bio-Matrix procedure are issues of first impression. Petitioner believes that the term should include the procedure under both the plain meaning of restoring and the common industry meaning of hair restoring services.

30. Even if the Bio-Matrix procedure is not found to be a hair restoring service, petitioner argues that its primary function is to provide a nonenumerated, nontaxable service and not to sell tangible personal property or to provide maintenance and services to such property.

Petitioner argues that the primary function of the Bio-Matrix procedure is not the sale of tangible personal property and the provision of maintenance and services to that property. Rather, the Bio-Matrix system's primary function is the continuous provision of services to develop and maintain an image and lifestyle.

31. Petitioner argues that the Division did not have a rational basis for its assessment and that petitioner introduced evidence that both rebutted the presumption of correctness raised by the issuance of the assessment and exposed the irrationality of the assessment demonstrated by the Division's case.

32. The Division contends that petitioner is merely selling tangible personal property, i.e., the hairpiece or matrix. The Division notes that petitioner's new business model is merely the bundling of the sale of the matrix and all of the services connected with preparing the scalp for its installation, styling and upkeep. The Division takes the position that where sales of a taxable

and nontaxable nature occur, sales tax is due on the total amount of the receipt where taxable and nontaxable services are not separately stated.

33. The Division argues that petitioner is actually claiming an exemption from tax and must prove its entitlement to same. The Division believes that its interpretation of the term hair restoring must be adopted because, as the agency charged with administering the Tax Law, it is entitled to deference on such matters and petitioner has not proven that its interpretation is the only reasonable interpretation of the term.

CONCLUSIONS OF LAW

A. Petitioner has asserted that the Division has not demonstrated a rational basis for its assessment in this matter, relying on *Matter of Atlantic & Hudson Limited Partnership* (Tax Appeals Tribunal, January 30, 1992), which provided that a petitioner could rebut the presumption of correctness and establish that the audit was irrational at hearing through the introduction of evidence that revealed such irrationality. However, this argument overlooks the fact that the Division was relying on *Matter of Allen Arthur Co., Inc.* (State Tax Commission, October 6, 1978), which concerned a very similar process to that described by petitioner but characterized as the installation of tangible personal property and the styling services as the maintaining and servicing of same, both taxable pursuant to Tax Law § 1105(c)(3). Further, when confronted with the argument that the services rendered by petitioner under its new business model during the last quarter of the audit period constituted hair restoration, the Division relied on a definition of that term that petitioner itself uses on its web site, i.e., that hair restoration is hair transplantation performed by a physician.

Given these facts, it cannot be concluded that the Division's assessment lacked a rational basis. Its reliance on the facts presented and the *Matter of Allen Arthur Co., Inc.* provided a

rational basis on which it could have concluded that petitioner was making sales of tangible personal property and the services to maintain such property. The fact that the Division did not agree with petitioner's legal interpretation and claim to an exclusion from tax does not mean it lacked a rational basis for issuance of the notice.

B. Tax Law § 1105(a) and (c) impose a sales tax on the retail sale of tangible personal property and certain enumerated services. Included in the enumerated taxable services is the service of installing tangible personal property, or the maintaining, servicing or repairing of tangible personal property not held for sale in the regular course of business. (Tax Law § 1105[c][3].) The parties have agreed in their Stipulation of Facts that hair restoring services are not one of the enumerated taxable services for purposes of the Tax Law. Although the Governor had proposed adding hair restoring to the list of enumerated taxable services as part of the 2009-2010 Executive Budget, it was never enacted. The proposal would have added a new section 1105(a)(10) to the Tax Law to impose sales tax on "beauty, barbering, hair restoring, manicuring, pedicuring, electrolysis, massage services" and similar services. (2009-2010 New York State Executive Budget, Revenue Article VII Legislation, Memorandum in Support, Part V, pp. 32-33.) This proposal would have conformed the Tax Law with the New York City Administrative Code, as hair restoring services were taxable in New York City during the period in issue pursuant to Tax Law § 1212-A(a)(2) and Administrative Code § 11-2002(h).

Therefore, defining hair restoration is critical to the determination of this matter. To determine if the Bio-Matrix procedure is a sale and servicing of tangible personal property or a nontaxable service of hair restoration, there must be an understanding of the term hair restoration.

In the first instance, although the proposed New York State legislation and the New York City Administrative Code explicitly taxed the service of hair restoring, neither defined it. That said, it is noted that both sections specifically excluded from the enumerated list of taxable services those rendered by a physician. Since hair transplantation is a service performed by a physician, it stands to reason that it was not meant to be an enumerated service under either provision.

Because the term hair restoring or hair restoration is not defined in the Tax Law, its regulations, the New York City Administrative Code or the regulations promulgated thereunder, it is reasonable to interpret the words of Tax Law § 1212-A(a)(2) and Administrative Code § 11-2002(h) in accordance with their plain terms, using a literal construction. (McKinney's Cons Laws of NY, Book 1, Statutes § 94.) This is consistent with the rule that words of ordinary import are to be given their usual and commonly understood meaning, unless it is clear from the statute that a different meaning is intended. (McKinney's Cons Laws of NY, Book 1, Statutes § 232.)

The word restoration is defined as “an act of restoring or the condition or fact of being restored as a bringing back to or putting back into a former position or condition.” (Webster's Third New International Dictionary of the English Language 1936 [1986].)

Therefore, it can be deduced that, for purposes of the statutes, hair restoring is a service, not performed by a physician, which seeks to put a scalp back in a former condition. In *People v. Rubin* (103 Misc 2d 227, 424 NYS2d 592 [1979]) [the defendant, accused of the unlawful practice of medicine, challenged the constitutionality of the statutes defining the offense], Judge Glass of the Criminal Court of the City of New York noted the following in a well-researched opinion:

Persons suffering from alopecia (baldness) have subjected themselves to various techniques in desperate attempts to restore their lost hair with results ranging from fair to disastrous. *Excluding the use of wigs and toupees, the most commonly used methods of hair restoration include the hair weave, hair transplantation, suture implantation, and synthetic hair implantation.* The hair weave involves weaving the a [sic] toupee into the scalp hairs usually providing a good cosmetic effect depending on its density but often result in a traction type of baldness. Natural hair transplantation, the most widely used permanent hair restoration technique, is a generally accepted medical procedure as practiced by dermatologists, plastic surgeons, general surgeons and others. It involves the surgical transfer of cylindrical full-thickness skin grafts from hair-bearing areas of the treated person's own scalp to a bald area. This punch grafting or autografting has been used for many years by reputable physicians with little adverse medical effect and fairly good cosmetic effect. (Emphasis added.)

The italicized text indicates that the Judge construed hair restoration as comprised of many methodologies, including wigs, toupees, weaves, and transplantation. Although the Bio-Matrix process was not named, it would certainly be within the scope of hair restoration as contemplated by the plain language of the statutes, the dictionary definition and the definition in the **Rubin** case.

The Bio-Matrix process brought the client's scalp back to its former condition, through its addition of hair several times a year, continuous cutting, styling, blending, coloring, etc. That there are many processes that fall within the definition of hair restoring or restoration, is undeniable. Petitioner offers medical hair transplantation and hair therapy as well as the Bio-Matrix process, and several of its executives, who had decades of experience in the field, confirmed that the term hair restoration was a catch-all phrase, which, in the industry, encompassed all therapies used to bring back the former condition of having hair in places on the scalp that had become bald.

Petitioner provides what it believes to be the three proven options for hair restoration. The fact that petitioner offers medical transplantation by physicians, the Bio-Matrix process and hair

therapy marked a broadening in its scope of treatment of hair loss since its predecessor, Hair Restoration Center, did not offer the transplantation option. Thus, petitioner's interpretation of hair restoration included medical hair transplantation. Consistent with this interpretation is the fact that petitioner's corporate parent, Regis Corporation, referred to petitioner in its Form 10-K for the period ended June 30, 2007 as a provider of hair restoration services and notes that it provides a comprehensive menu of hair restoration services.

Given these diverse interpretations of the term hair restoration or restoring referred to above, it is concluded that the Bio-Matrix process falls within the definition of what is commonly referred to as a hair restoration or restoring service. Therefore, it is not one of the enumerated taxable services set forth in Tax Law § 1105(c) and should not have been taxed by the Division herein.

C. The Division contended that the term hair restoration only encompasses the surgical procedure to permanently correct male pattern baldness, performed by physicians specializing in the area. In support of this assertion it cites Wikipedia, an internet encyclopedia, the content of which is contributed by volunteers worldwide who may or may not have an expertise in the area they choose to edit. Wikipedia is ever-changing since anyone can edit its content at any time. Although somewhat suspect as a basis for an assessment, the Wikipedia definition gains more credibility when compared with an entry on petitioner's web site, which, in a frequently asked question (FAQ), defines hair restoration in almost identical words. This definition directly conflicts with petitioner's argument that the Bio-Matrix process is a hair restoration service. It also conflicts with the analysis above, which determined that the statutory provision that subjects hair restoring services to sales tax specifically excludes the services rendered by a physician.

In fairness to both the Wikipedia definition and the FAQ answer on petitioner's web site, it is assumed that neither was drafted for purposes of the New York State sales tax. Therefore, the relevance of both definitions is minimal and accorded little weight. To accept either of these definitions would nullify the meaning of the term hair restoration determined above, which provides a meaningful interpretation of the statutory provisions of Tax Law § 1212-A and Administrative Code § 11-2002(h). If this forum were to accept the Wikipedia definition proposed by the Division or the definition from petitioner's web site, hair restoring services would never be taxable because they would, by definition, always be performed by a physician and exempt from taxation. Since it has been established that there are other hair restoration procedures that are not performed by physicians, both definitions will be ignored and accorded minimal weight.

D. The Division has conceded that petitioner provided hair restoring services during the period in issue and that it paid use tax on the products used in that service. It has also conceded that hair restoring or restoration is not one of the enumerated taxable services set forth in Tax Law § 1105(c). Despite these seemingly contradictory concessions, the Division contends that the sale of the Bio-Matrix process pursuant to the membership agreements is actually the sale of a hairpiece or head of hair, i.e., tangible personal property, which is taxable as the retail sale of tangible personal property. (Tax Law § 1105[a]; 1101[b][5].) However, the Division does not believe this position is dispositive because it believes that petitioner performs only some hair restoration procedures and that it primarily sells hairpieces. It contends that petitioner's failure to separately state the services it renders and tangible personal property it sells makes it impossible to tell what the hair restoration services are or their value. Therefore, the entire receipt must be taxable.

The Division maintains that the change in business model was merely the change in how a customer was billed for a hairpiece. Prior to 2003, the year by which all clients were enrolled in membership programs, petitioner did make retail sales of hairpieces and services to clients and separately charged for them. On and after December 1, 2006, petitioner changed the fee structure to reflect one charge, the sale of the service of hair restoration, or, for purposes of this matter, the Bio-Matrix process.

The Division takes the position that there was no change in what was sold or the primary focus of the transaction. It argues that petitioner was making a sale of hairpieces before the change and after, only now charging one fee for the hair and services. The Division believes that this bundling of tangible personal property and the charges for servicing and maintaining the property pursuant to its agreements only served to make it impossible to separate the taxable and nontaxable items. It argues that under such circumstances, the entire receipt is subject to sales tax. (*Matter of Artex Systems, Inc. v. Urbach*, 252 AD2d 750, 676 NYS2d 284 [1998]; *Matter of Zagoren*, Tax Appeals Tribunal, May 19, 1994 [the receipts from the sale of the tangible personal property, a graphic design, cannot be broken down into the taxable and nontaxable services involved in the production of the tangible personal property.] Since, in the Division's opinion, the agreements for the sale of the Bio-Matrix process were merely agreements to sell a hairpiece to a client, together with all the other services rendered in connection therewith, the entire bundled receipt was subject to tax. However, as discussed below, such a characterization was unwarranted in light of the evidence.

E. The Division argues that petitioner bears a heavy burden of proof since it is seeking an exemption from tax. (*Matter of Grace v. New York State Tax Commission*, 37 NY2d 193, 371 NYS2d 715 [1975].) The Division contends that petitioner is looking for an exemption from the

tax on retail sales of tangible personal property. (Tax Law § 1105[a].) However, petitioner is not seeking an exemption, but an exclusion from the tax.

In contrast to Tax Law § 1105(a), which imposes sales tax on all retail sales of tangible personal property, except as otherwise provided, Tax Law § 1105(c) imposes tax on specific enumerated services. Accordingly, whether a service is taxable as one of the specifically enumerated services is properly construed pursuant to the rule applicable when determining whether a transaction is subject to taxation at all (*see Matter of Grace v. New York State Tax Commn.*) that is, most strongly against the government and in favor of the citizen (*see Matter of Building Contractors Association v. Tully*, 87 AD2d 909, 449 NYS2d 547 [3d Dept 1982]). This rule of construction stands in contrast to the rule with respect to exemptions from tax, i.e., strictly and narrowly against the taxpayer (*see Matter of International Bar Assn. v. Tax Appeals Tribunal*, 210 AD2d 819, 620 NYS2d 582 [3rd Dept 1994], *lv denied* 85 NY2d 806, 627 NYS2d 323 [1995]).

However, even with such a construction, proof of entitlement to the exclusion is petitioner's burden and it must show that the hair restoration service it provides is not one of those set out in Tax Law § 1105(c).

F. Prior to petitioner's change in business model, it had made retail sales of wigs and toupees as tangible personal property, also installing same with various methods including weaves and velcro. Petitioner charged and collected the appropriate tax on these sales. With its development and refinement of Polyfuse and the fine, natural hair matrix, petitioner realized that hair loss treatment through the Bio-Matrix process had a much greater potential to improve self-image and boost confidence in its clients. A corporate decision was made to withdraw from the business of selling hairpieces and shift its emphasis - - change its business model - - to providing

a service which could accomplish the goal of improving self- image and confidence with the highest quality materials, specialists and stylists, all accomplished with the utmost confidentiality. In essence, petitioner committed to a service oriented model that required it to ensure that its clients always reflected the best quality in hair restoration.

By 2003, petitioner had accomplished its goal of enrolling all clients in its membership programs. Those who chose to continue purchasing hairpieces ended their relationship with the company. If petitioner was to offer the best in hair restoration services, it needed to control the quality of the end product of its services. Demanding that every client be a member allowed it to accomplish this goal and control the quality of its product and protect its public image.

The membership agreements were all-inclusive in nature, providing the application service, full service, chemical service and shampoo and style service. The number of services in each category members received was directly related to the service level they enrolled in. The basic agreement provided for three application services, three full services and three chemical services. The most generous membership level, presidential, provided for 26 application services and unlimited numbers of all other services.² The agreements were tailored to serve the twin corporate goals of quality and image.

In contrast to the previous business model, the client's confidentiality was protected with great care under the new model, from no signage at its business locations to private rooms for meetings with hair loss specialists and stylists. Petitioner made a total commitment to ensuring that it bestowed a new image upon its client that was natural, tangible and known only to

²It is noted that the numbers of services under the female membership agreements are smaller. The examples are from the male agreements and are meant to underscore the importance and emphasis placed on services by petitioner.

petitioner's employees and clients, fostering a mystique that helped further boost confidence, improve personal image and self-esteem and create value in the Hair Club brand.

The analysis of the Bio-Matrix process outlined in the facts demonstrates that clients are not purchasing hairpieces. That option is readily available through a multitude of outlets at many prices and with varied results. As mentioned, clients seeking a mere hairpiece were jettisoned by 2003. Petitioner's membership clients seek a quality "look" or image that can only be delivered by highly skilled specialists and stylists using cutting edge technology. It is a creative process that strives to deliver something more than just a wig, be it a personal dream, quest for youth or something as simple as regaining a part of one's persona lost with age. Therefore, it cannot be said that what is primarily being sold pursuant to the membership agreements is tangible personal property.

Service is stressed in the membership contract as well as in the management of the centers. The membership agreement *requires* members to return for care, servicing and grooming every four to eight weeks after an application service and that the head of hair, or matrix, *must* be returned to petitioner when a subsequent application service is performed. If a client's goal was to purchase a toupee or wig, he or she would not enter into a membership agreement with petitioner that places such an overwhelming emphasis on services and demands return of the hair and mandates upkeep on regular intervals. The exhaustive description of the Bio-Matrix process indicates that clients, in conjunction with hair loss specialists and stylists, create a new image for themselves and enter into an agreement to fashion that image and maintain it throughout the term of the contract. The contract makes it clear that clients must participate in the process to the extent that they must, in some instances, apply adhesive, use specific hair care products to maintain their image and return to a hair care center on a regular basis for the services of a stylist.

G. The Division relied on *Matter of Allen Arthur Co., Inc.* (State Tax Commission, October 6, 1978),³ for the proposition that sales of hairpieces are taxable, even though the Tax Commission decision only concerned the taxability of the installation of the hairpiece and subsequent styling of same. The petitioner in that case conceded the taxability of the toupees and collected tax on its sales of them as verified by an itemized receipt. It paid no tax on the service of fusing the artificial hair to a client's head or styling services. The Tax Commission found the fusion to be the installation of tangible personal property and the styling to be maintaining and servicing tangible personal property, both pursuant to Tax Law § 1105(c)(3).

The *Allen Arthur* case concerned a business that operated on a basis closely resembling petitioner's prior business model and therefore cannot be viewed as a controlling precedent. It was not analyzed as a complete service of hair restoration seeking to accomplish the same ends as petitioner. On that basis, it is distinguishable.

Likewise, the Advisory Opinion cited by the Division, TSB-A-95(9)S, is also distinguishable because that matter sought a statutory exemption from tax on the basis that a hairpiece was a prosthetic device whose use was the result of a medical problem. The advisory opinion relied on the *Allen Arthur* decision to the extent that the fitting and fusion of the hairpiece was taxable as the installation of tangible personal property and reserved for a trier of fact the determination of whether the purchase of a hairpiece was the result of medical problems. Nowhere in the advisory opinion is the service of hair restoration discussed, even though the provision was enacted in 1971 for the City of New York.

³As decisions of a body of coordinate jurisdiction, the State Tax Commission decisions are not binding precedent, but are entitled to respectful consideration. (*Matter of Racal Corporation*, Tax Appeals Tribunal, May 13, 1993.)

H. There is no dispute that tangible personal property was transferred as an inseparable part of the Bio-Matrix process incident to the hair restoring service. Therefore, petitioner's reliance on *Matter of Atlas Linen Supply Co., Inc. v. Chu* (149 AD2d 824, 540 NYS2d 347 [1989]) is well founded. There the provision of linens was held to be "purely incidental to its primary or essential business of laundering." As such, the provision of linens and laundry services were found to be inseparably connected and could not be considered separate transactions for tax purposes.

The same reasoning is applicable here, where the incorporation of the matrix was incidental to the Bio-Matrix hair restoration service. The difference here is that petitioner perceived that and paid tax on its purchases of hair used to produce the matrix, which underscores a critical fact about the matrix and its relationship to the Bio-Matrix procedure. The filament matrix was designed to hold hair in places where needed and was meant to augment and blend undetectably with the client's own hair. The hair chosen for each client's matrix was carefully chosen to match the samples of the client's hair with particular attention to color, density, texture, diameter and thickness. The matrix was not a stock product that was taken from a shelf and attached to the client's head. It was created after the consultation with the hair loss specialist, an analysis of the hair sample and the measurements taken. The stylist worked with the client to achieve the right image and look for the individual. It was then attached to the client's scalp and natural hair with Polyfuse and cut and styled for the newly created image. The process is seamless and it follows that there would not be separate charges for the new hair or the various services performed as constituent parts of a hair restoring service.

I. The Division contends that by charging an annual fee for hairpieces and services that did not separately state the charges for components, petitioner precluded its customers from

purchasing hairpieces as a separate item. The Division reasons that where components cannot be singly purchased, Tax Law § 1101(b)(3) provides that the sale be treated as a single sale, the receipts from which are fully taxable. However, Tax Law § 1101(b)(3) pertains to taxes imposed by Tax Law § 1105(c) on taxable property and services. Since it has been concluded that hair restoration is not an enumerated taxable service pursuant to Tax Law § 1105(c), and the provision of the filament matrix an inseparable and inextricable part of that service and not a sale thereof, the receipt for such a service would not be subject to tax.

Despite the parties' arguments to the contrary, this forum will not delve into what is and is not a de minimis portion of the receipt, as measured in dollars, for the nontaxable service of hair restoration. Each of the parties tried to justify the actual value of the filament hair matrix, but neither had proof of the actual cost to petitioner. The Division tried to estimate the cost of the hair from outdated historical sales of toupees by petitioner years prior to the audit period and its financial statements from 2007, all of which amounted to wild speculation. Petitioner offered testimony based on vague references to inspection of a general ledger that was not introduced into evidence. Had either party wanted to seriously pursue the de minimis argument, it was incumbent upon it to offer credible proof of specific value. Failing such a demonstration, and based upon the documents and testimony in the record, arguments that the hair had or did not have a de minimis value do not pass evidential muster and are rejected.

J. The petition of Hair Club for Men, LLC is granted and the Notice of Determination, dated October 31, 2008, is canceled.

DATED: Troy, New York
August 19, 2010

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE