STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
44TH ENTERPRISES CORPORATION	:	
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 2010 through February 28, 2014.	:	DECISION DTA NOS. 828639 AND 828640

In the Matter of the Petition	:	
of	:	
MLB ENTERPRISES CORPORATION	:	
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 2010 through February 28, 2014.	:	

Petitioners, 44th Enterprises Corporation and MLB Enterprises Corporation, filed an exception to the determination of the Administrative Law Judge issued on February 18, 2021 and to the order of the Administrative Law Judge issued on August 5, 2021. Petitioners appeared by Meister Seelig & Fein LLP (Amit Shertzer, Esq., and Kevin A. Fritz, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioners filed a brief in support of the exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument was heard by teleconference on February 17, 2022, which date began the six-month period for the issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioners' motion to reopen the record or for reargument should be granted.

II. Whether the Division of Taxation correctly determined that sales of scrip at petitioners' clubs were subject to tax.

IIII. Whether petitioners were responsible persons within the meaning and intent of Tax Law §§ 1131 (1) and 1133 (a) for the collection and payment of sales tax on the sales of scrip for the period March 1, 2010 through February 28, 2014.

IV. Whether petitioners have met their burden of proving that the Division of Taxation erred in its determination of additional tax due.

V. Whether petitioners are entitled to estoppel against the Division of Taxation.

VI. Whether petitioners have shown that the assessments violate the federal and state constitutions.

VII. Whether petitioners have met their burden of showing reasonable cause for the abatement of penalties.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge in her determination and order, except that we have not restated the Administrative Law Judge's finding of fact 65 (the Administrative Law Judge's rulings on proposed findings of fact) and we have renumbered the findings of fact in the order as 65 and 66 herein. We have added additional findings of fact numbered 67 and 68. We have also modified findings of fact 4, 9, 12, 21, 55, and 59 to more fully reflect the record. The Administrative Law Judge's findings of fact, the modified findings of fact, and the additional findings of fact appear below.

1. Petitioners, 44th Enterprises Corporation (44th) and MLB Enterprises Corporation (MLB), operated adult entertainment clubs (collectively referred to as the Clubs) in New York, New York, during the period March 1, 2010 through February 28, 2014 (the period at issue). MLB's club, doing business as Lace Gentlemen's Club, was located on 7th Avenue, and 44th's club, doing business as Lace II Gentlemen's Club and subsequently Diamond Club Gentlemen's Cabaret, was located on 8th Avenue. The Clubs are no longer operational.

2. During the period at issue, petitioners were owned by Anthony Capeci as the sole shareholder and president. Apart from Mr. Capeci, petitioners did not have any other officers or directors. Mario Barnes was a manager of MLB's club, and an individual named Don[1] was a manager of 44th's club.

3. Petitioners' Clubs were run in the same manner. Petitioners claim that the Clubs' sources of revenue consisted of door admissions, coat check charges, bar sales of alcoholic and non-alcoholic drinks, and admission charges for the use of private rooms. The Clubs' revenue also included fees and charges collected from the Clubs' dancers (***see*** finding of fact 4).

4. Petitioners' Clubs engaged individuals to perform adult entertainment/exotic dancing services for the patrons of the Clubs.[2] A sample contract between the dancers and MLB provided by petitioners during the audit indicates that the dancers were required to pay petitioner MLB $150.00 per performance date, $150.00 per 30 minutes for use of the "champagne room," and $500.00 per hour for the use of the "viper room." Similarly, contracts between individual dancers and petitioner MLB and petitioner 44th, respectively, offered in evidence at hearing by petitioners indicate an agreement by the dancers to pay the clubs $150.00 per performance date.

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[1] This individual's last name is not contained in the record.

[2] The individuals are referred to herein as dancers, entertainers, or performers.

The same contracts state that the dancers are entitled to keep "all dance fees paid to her and all 'tip' [sic] (gratuities) given to her by patrons during her performance date." Additionally, in Mr. Capeci's and petitioner 44th's response to plaintiff's first request for admissions in ***Dennis v 44th Enterprises Corp. and Capeci*** (Sup Ct, NY County, Freed, J, Index No. 153420/2016), dated July 1, 2019, 44th admitted that it charged the dancers various fees, including house fees and late fines.[3] All of the contracts in evidence expressly provide that the dancers are not to be considered employees of the Clubs.

5. Each of the Clubs had a main room where dancers performed on stage, around which there were tables, chairs, and couches for customer use. To gain entry to the Clubs, patrons paid an admission fee, depending on the time of day, which allowed them to view live exotic performances on stage in the main area of the Clubs. In addition to the main area of the Clubs, petitioners offered various private rooms throughout the Clubs where customers could have private entertainment for an additional charge. The private rooms did not have stages or props. Each Club also had a second floor that could be used for private parties.

6. To gain access to the private rooms, petitioners charged customers a separate admission charge. The Clubs set the price for private room rentals. The prices for the private rooms varied depending on the size of the room, amount of time in the room, and how many customers and dancers were in the room. Customers could pay for private rooms by cash, credit

[3] Official notice of the record of the proceedings in ***Dennis v 44th Enterprises Corp. and Capeci***, (Sup Ct, NY County, Freed, J, Index No. 153420/2016) is taken pursuant to State Administrative Procedure Act (SAPA) § 306 (4). Pursuant to SAPA § 306 (4) official notice can be taken of all facts of which judicial notice could be taken. The Division of Tax Appeals may take official notice of official court records and filings from other state and federal actions and proceedings (***see e.g. RGH Liquidating Trust v Deloitte & Touche LLP***, 71 AD3d 198, 207-208 [1st Dept 2009] ***revd on other grounds*** 17 NY3d 397 [2011]). Although petitioners entered the complaint in the ***Dennis*** proceedings into the record in this matter, they did not enter the complete record. As such, official notice of the full record of proceedings, including affidavits submitted therein, and 44th's and Capeci's answer and admissions (herein referred to as the ***Dennis*** matter answer and the ***Dennis*** matter admissions), is taken.

card or scrip.[4] Scrip (also known as funny money or Lace dollars) is a fictitious currency patrons could purchase at the Clubs with a credit card.

7. According to Mr. Capeci, customers were not required to have live entertainment, such as dances, in the private rooms. During a field audit visit by the Division of Taxation's (Division) auditor, Mr. Capeci stated that when a customer is in a private room, the drinks are free. During an investigation of MLB's club conducted by the Division's investigators, the Club's manager stated that lap dances in private rooms ranged from $160.00 to $900.00 for ten minutes. During an investigation of 44th's club by the Division's investigators, the Club's manager stated that charges for private rooms range from $300.00 to $1,100.00 per hour, depending on the number of customers and how many entertainers are in the room at once.

8. Some summary register tapes (z tapes) provided by petitioners during the audit showed charges separately categorized for private rooms rentals and bar; a separate register was used for admission and coat check charges.

9. Petitioners employed waitresses, bartenders, bar backs, managers and disc jockeys to work in the Clubs. Petitioners also engaged dancers to perform at the Clubs. While petitioners contend, and Mr. Capeci testified during the hearing, that the dancers were employees of the Clubs, Mr. Capeci stated during the audit that the dancers were "tenants" of the Clubs and that they were neither employees nor independent contractors. Petitioners did not withhold any employment taxes or pay workers' compensation for the dancers. In the ***Dennis*** matter answer, 44th and Mr. Capeci affirmatively stated that the dancers were independent contractors, not

[4] Although petitioners' witnesses testified that scrip could not be used to pay for private room rentals, this testimony is contradicted by petitioners' exhibit 43, which indicates that from at least January 2010 through October 2012, the Metro credit card "batch" amounts for scrip sales at petitioner MLB's Club regularly included charges for private rooms (***see*** finding of fact 21).

employees. In the ***Dennis*** matter admissions, 44th and Mr. Capeci admitted that they categorized the dancers as independent contractors and that they should have categorized them as employees.[5] In their briefs below and on exception, petitioners concede that the dancers were employees. 44th and Mr. Capeci further admitted in the ***Dennis*** matter admissions that the dancers did not receive compensation (i.e., hourly, salaried or otherwise) from them.[6]

10. Petitioners set rules for how the dancers performed their work in the Clubs, including setting the work hours and shifts, and controlling the music that the dancers used. Petitioners considered the dancers to be an integral part of the Clubs' business.

11. Patrons could purchase lap dances at the Clubs by paying cash or using scrip. The use of scrip allowed customers to make purchases with a credit card rather than using cash. A customer would purchase scrip through the Clubs' waitresses or managers, who would run the charge through a credit card terminal maintained by a third party, Metro Enterprises Corp. (Metro). Patrons paid a 20% surcharge on every purchase of scrip (i.e., a customer is charged $120.00 in order to receive $100.00 of scrip). The dancers paid a 10% redemption fee when they redeemed the scrip for cash. MLB and 44th's credit card terminals were also used to process scrip transactions on occasion. According to petitioners' witness, John Scarfi, such transactions on petitioners' credit card terminals occurred a couple of times a week when there was a problem with Metro's terminal. The Clubs and Metro did not use any tax form or other forms to reconcile or explain Metro's use of the Clubs' credit card terminals.[7]

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[5] ***See*** footnote 3.

[6] ***Id.***

[7] Mr. Capeci's testimony during the hearing in this matter that Metro and the Clubs did not use any tax form or other forms to reconcile or explain Metro's use of the Clubs' credit card terminals contradicts Mr. Scarfi's testimony in ***Matter of Metro and Scarfi*** (DTA Nos. 828745 and 828746, July 25, 2019), that when the Clubs used Metro's credit card terminals or vice versa, Metro reported it in a form 1099-K filed with the Internal Revenue Service (IRS). Petitioners introduced the transcript from ***Matter of Metro and Scarfi*** into the record for this matter.

12. Scrip could be used at the Clubs to purchase dances, tip dancers and waitresses,[8] and, at least at petitioner MLB's Club, pay for the use of private rooms.[9] Customers were not required to use scrip for payment and could use cash instead.

13. According to Mr. Capeci, the dancers would negotiate the price for a personal dance with the customer.[10] Although Mr. Capeci testified that the Clubs maintained a "suggested minimum" amount for dances and no fixed price, he stated during the audit that dances on the main floor of the Clubs are $20.00 each. Additionally, during the hearing in the ***Matter of Metro and Scarfi*** (DTA Nos. 828745 and 828746, July 15, 2019),[11] Mr. Capeci testified that "[i]n order to create harmony in the workplace we have a suggested minimum of a twenty dollar dance fee and if you go to any club that twenty dollars is pretty much everywhere." Mr. Capeci later contradicted himself in the ***Matter of Metro and Scarfi***, stating that "there are no dance fees . . . ." During the Division's investigator's visit to MLB, the Club's manager stated that a lap dance in the main room is $20.00 per song, and ranges from $160.00 to $900.00 in the private rooms. The manager at 44th's club informed the Division's investigator that lap dances on the main floor are $20.00. The customers may also give the dancers voluntary gratuities in scrip or cash.

14. Mr. Capeci further testified that any payment received by a dancer directly from a customer was "deemed to be a tip." However, his testimony is contradicted by the ***Dennis***

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[8] Although petitioners contend that scrip could only be used to tip dancers, petitioners' witness, Mr. Scarfi, presented contradictory testimony, stating first that a customer could not use scrip for anything other than tipping dancers, but later testifying that scrip could also be used to tip the Clubs' waitresses. In Mr. Scarfi's affidavit, dated January 30, 2018, submitted in the ***Dennis*** matter, he affirms that "[p]atrons often used scrip for 'tips' *in addition to 'dancer fees'*" (emphasis added) (***see*** footnote 3).

[9] ***See*** footnote 4.

[10] It is noted that in the ***Dennis*** matter, plaintiff Louisa Dennis's affidavit states "I did not set the price for dances – Lace II did" (***see*** footnote 3). Ms. Dennis was a dancer at 44th's Club.

[11] As noted above, petitioners introduced the transcript from the ***Matter of Metro and Scarfi*** into the record

matter answer, in which 44th and Mr. Capeci denied plaintiff Dennis's allegation that the club's customers reasonably believed that 100% of the tips would be given to employees and affirmatively state that "some or all of the payments received by Plaintiff for performances were administrative charges, which a reasonable customer should understand were not gratuities . . . ." (***see*** footnote 3).

15. Mr. Capeci testified that petitioners did not keep track of gratuities paid to dancers. This testimony is contradicted by the testimony of Mr. Scarfi, who testified that ledger books showing scrip payments to dancers, which petitioners allege were gratuities, were prepared by the Clubs' managers. According to Mr. Capeci, petitioners did not include scrip sales in their gross receipts.

16. During the audit of the Clubs, Mr. Capeci provided the auditor with envelopes containing some records of scrip sales (***see*** findings of fact 28 and 40).

17. Metro provided the Clubs with dancer referrals and credit card terminals for the exchange of credit card payments into scrip (***see*** finding of fact 11). The credit card terminals were maintained inside the Clubs and were operated by the Clubs' employees.

18. Petitioners benefitted from utilizing Metro's services in the Clubs because Metro took on the risk of handling customer "chargebacks" on disputed credit card payments and enabled customers to use scrip, purchased by credit cards, instead of using cash in the Clubs, which allowed customers to stay longer and make additional drink purchases.

19. In order for dancers to redeem scrip received from a customer into cash, they were charged a 10% redemption fee. As described by Mr. Capeci, the dancer would redeem the scrip for cash through a manager of the Clubs, who would place the scrip vouchers in a lockbox and

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in this matter.

pay out cash to the dancer corresponding to the voucher amount, less the redemption fee. Evidence in the record indicates that on occasion other fees, such as rent, were also deducted from the scrip amounts upon redemption. The managers who sold the scrip to the patrons and exchanged the scrip into cash for the dancers were employees of the Clubs. According to Mr. Capeci and Mr. Scarfi, the cash used to redeem the scrip came from Metro's bank account and was kept in a safe located in the Clubs.

20. According to Mr. Scarfi, Metro treats the administrative fees for the sale and redemption of the scrip as income on its books and does not report cash paid to dancers or credit card payments for scrip purchases in its gross receipts. Mr. Scarfi testified that, "Well, the customer, the guy who's supposed to be paying the sales tax, paid me a 20 percent service charge, so let's call it $120. So the $20 service fee he paid me, the $100 he paid the entertainer, and then the entertainer paid me a 10 percent redemption fee. So that's 25 percent me, 75 percent the entertainers, and that's how it's reflected on the federal 1120 tax return, only the 25 percent." However, petitioners' witness, Nicole Bux, an accountant for Metro, testified that Metro had not filed income tax returns for 2008 through 2014 until 2015 and that an IRS audit of Metro was ongoing.

21. During the hearing, petitioners introduced into the record documents they described as copies of ledger books (exhibits 42 and 43), and some individual ledger pages (exhibit 17). Although the ledgers in exhibits 42 and 43 are not labeled as MLB or 44th, Metro's batch reports attached to the ledger pages (described below) identify the location of the particular club by street address. Specifically, the batch reports in exhibit 42 list, where legible, 44th's 8th Avenue address. The batch reports in exhibit 43 list, where legible, MLB's 7th Avenue address, except

for the period January 2011 through January 2012, where the batch reports in exhibit 43 contain no address. It is concluded, therefore, that the ledger books in exhibit 42 pertain to petitioner 44th and the ledger books in exhibit 43 pertain to petitioner MLB. Although petitioners described exhibit 17 as an exemplar of exhibits 42 and 43, a comparison of the exhibits reveals that exhibit 17 consists of selected ledger pages from exhibit 42. Exhibits 42 and 17 have some column captions that differ from column captions in exhibit 43. One such difference is that, for the January 2010-December 2012 period, exhibit 43 contains a column caption for "Rooms," thus indicating that MLB's private room charges were paid in scrip and were included in Metro's credit card summary report totals, as discussed below. Additionally, the handwritten ledger entries in exhibits 42 and 43 do not reconcile with the credit card batch summaries, in contradiction to Mr. Scarfi's testimony.

According to Mr. Scarfi, the "batch report" (summary credit card totals) shows the daily total scrip charges processed by Metro, including additional tips for the Clubs' waitresses. Describing the first ledger page in exhibit 17, Mr. Scarfi states that from the credit card total, they subtract the waitress tips and Metro's 20% transaction fee, to arrive at a total amount for the sale of vouchers and "pieces" (described as a generic form of scrip without any dancer's name). According to Mr. Scarfi, the following page of exhibit 17 shows that the amounts for the scrip were redeemed by the dancers. Although Mr. Scarfi claims that these documents demonstrate that the dancers redeemed the full amount of scrip purchased by customers, less the service and redemption fees, a review of the records contradicts his testimony and shows that the credit card transactions do not reconcile with the amount of scrip paid out to the dancers. Additionally, although Mr. Scarfi claims that the ledgers show that the dancers signed their names to indicate

they redeemed the scrip vouchers, a review of exhibits 17, 42 and 43 show that signatures do not appear for each line corresponding to the dancer's name, and on some lines the word "rent" is written instead of a signature.

Exhibit 42 contains copies of ledgers for the periods January 2010 through November 2013 and January 2014 through December 2014.[12] Exhibit 43 contains copies of ledgers for the periods January 2010 through May 2010, July 2010 through May 2012, July 2012 through December 2012, January 9, 2013 through January 19, 2013, March 9, 2013 through March 11, 2013, June 12, 2013 through November 2013, February 2014 through May 2014, and July 2014 through December 2014. The copies of the monthly ledgers in Exhibit 42 have the handwritten notation "FM Book" on the front of each month. The copies of the monthly ledgers in Exhibit 43 have the handwritten notations "FMC," "FM Book," or "Funny Money Book." The ledgers were prepared by the Clubs' managers.

Most of the ledger entries include a copy of a settlement report that shows the daily summary credit card totals from Visa, Mastercard, and American Express, described by Mr. Scarfi as a "batch report." The credit card totals on the settlement reports are not broken down for each charge and do not indicate what the charges are for. The settlement reports have Metro's name at the top and, as noted, for the most part also list an address. The settlement reports appear to be stapled or otherwise attached to the daily ledger pages for the corresponding dates.

In exhibit 43, the ledgers for 2010 through 2012 indicate that Metro's credit card batch

[12] Exhibit 43 as submitted contains two different ledgers for November 2012 and exhibit 42 as submitted does not contain a ledger for November 2012. A review of the batch reports in these ledgers indicates that one pertains to 44th and one to MLB. Accordingly, we consider the November 2012 ledger for 44th to be part of exhibit 42.

totals include credit card payments for the Clubs' private rooms. For example, for January 2, 2011, the settlement report shows total credit card receipts of $4,265.00. The corresponding handwritten ledger shows:

"Batch 4265
Tips 40
Rooms 1225
Total 3000
1.2 2500"

The ledgers for 2010 through 2012 in exhibit 43 also show columns with handwritten entries for "V#," "V$," "L$," "%," and "P/O," with amounts in each column, and a final column labeled "sign," followed by what appears to be signatures for some, but not all, of the entry lines. The amounts for the V$ and L$ do not reconcile with the credit card settlement reports.

Also in exhibit 43 is a ledger with a handwritten notation on the front stating:

"Start: 1-9-13
3-11-13"

A review of this ledger shows that it only contains entries for January 9, 2013 through January 19, 2013, and March 9, 2013 through March 11, 2013. The ledger has handwritten columns with the captions "V#," "V$," "L$," "%," "P/O," and "sign." It also has a number of pages with no dates or entries in the captioned columns and no credit card batch receipts. The amounts for the V$ and L$ do not reconcile with the credit card settlement reports.

The ledger for the period June 12, 2013 through July 20, 2013 in exhibit 43 has columns with the handwritten captions "name," "V#," "P/O," and "sign" on the first page for each dated entry, and "name," "L$," "%," "P/O," and "sign" on the second page for each dated entry. Several of the ledger pages from June 16, 2013 through June 25, 2013 do not contain any entries for the columns labeled "V#," "P/O," and "sign." Additionally, from June 28, 2013 to July 11,

2013 and July 13, 2013 through July 20, 2013 there are no entries for the columns labeled "V#," "P/O," and "sign." The amounts in the handwritten ledgers do not reconcile with the credit card settlement reports.[13]

The ledgers in exhibit 43 for the periods July 21, 2013 through November 15, 2013, and February 2014 through December 9, 2014 do not contain voucher numbers or amounts and contain only entries for names, L$, %, P/O, and signatures. The credit card batch totals do not reconcile with the amounts shown on the ledgers.

The ledgers in exhibit 42 similarly contain credit card settlement reports with Metro's name attached to handwritten ledgers. The ledgers include columns for names, "V#," "V$," "L$" (sometimes "D$"), "%," "P.O" and "sign." In most instances, the amounts for the V$ and L$ (or D$) do not reconcile with the credit card settlement reports.

22. MLB and 44th maintained separate bank accounts. Both Mr. Capeci and Mr. Scarfi had signatory authority on MLB's accounts at TD Bank and 44th's account at Bank of New Jersey. Mr. Capeci and Mr. Scarfi testified that Mr. Scarfi did not sign any checks on behalf of MLB or 44th. However, Mr. Scarfi admitted during testimony in the ***Matter of Metro and Scarfi*** that he did write checks to employees of MLB and 44th from Metro's bank account.[14] Mr. Capeci had check signing authority for Metro and signed checks on occasion.

23. The Division performed a sales tax audit of petitioners for the period March 1, 2010 through February 28, 2014.

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[13] For example, for June 15, 2013, the credit card batch report shows total charges of $41,796.00. The ledger shows two voucher numbers and amounts for "P/O" of 200 less 20, equaling 180, and 320 less 32, equaling 288, for a total of 468. The following page shows individuals' names, and entries under the column L$, totaling 17,140 plus an unexplained 220, equaling 17,360. The % column shows a total of 1,736 and the P/O column shows a total of 15,624 plus 468, for a total amount of 16,092. These figures do not reconcile with the credit card batch total.

[14] ***See*** footnotes 7 and 11.

24. By separate audit appointment letters and information documents requests (IDRs) to MLB and 44th, dated January 8, 2013, the Division's auditor, Jennifer Genovese, initiated audits of petitioners, initially for the period of March 1, 2010 through November 30, 2012.[15] The letters scheduled field audit appointments for each petitioner on January 29, 2013 and advised petitioners that they must provide "any and all documentation in auditable form and electronic form (if available) which supports the sales and use tax returns as filed." The attached IDRs described the books and records required to be produced.

25. On January 22, 2013, Mr. Capeci contacted Ms. Genovese on behalf of petitioners and requested that the Division reschedule the audit appointments to allow him time to gather the requested records. On March 4, 2013, the Division received a letter from Mr. Capeci requesting that the audits of petitioners be delayed until after the tax season. The audit appointments were rescheduled to June 3, 2013.

26. On June 3, 2013, Ms. Genovese and her supervisor, Christine Scala, conducted a field appointment for the audit of petitioners, and met with Mr. Capeci at his office. Mr. Capeci explained the operations of the Clubs to the Division's auditors. He informed the auditors that the Clubs operated from 12:00 p.m. to 4:00 a.m. daily, that there is no entrance admission charge from 12:00 p.m. to 8:00 p.m., and a $20.00 admission charge from 8:00 p.m. to 4:00 a.m. Mr. Capeci explained that patrons paid $20.00 for dances performed on the Clubs' main floors, and that customers can pay for the dances by cash or "funny money" (scrip) which is processed by a third party. Mr. Capeci further explained that both Clubs have three registers, one at the front for admission and coat check, one for the bar, and one for private rooms. Private and semi-

[15] By letters to MLB and 44th dated December 16, 2015, the Division informed petitioners that the audit period had been expanded to cover March 1, 2010 through February 28, 2014, and requested petitioners' books and

private rooms are available to patrons for an additional charge. The customer incurs two separate charges when utilizing a private room: a charge for the room and the dancer's fee. Mr. Capeci did not inform the auditors of the rates for private rooms at the Clubs. According to Mr. Capeci, the Clubs' taxable sales consisted of the admission charges, private room charges, drinks and coat check charges. Mr. Capeci explained that he used the Clubs' bank deposits to prepare the Clubs' sales tax returns. He provided sales tax backup records for the audit period, but bank statements and general ledgers were not made available to the auditors during the initial audit appointment. Mr. Capeci told the auditor that the ledger needed to be "cleaned up."

27. The Division sent second IDRs, dated June 10, 2013, to petitioners requesting the following: bank statements; general ledgers; federal returns; depreciation schedules; dancers' contracts; point of sale (POS) reports; register tapes; Z outs; batch summaries; prices lists for room rentals, services and dances; food and drink menus; promotional admission coupons and/or passes; purchase invoices for food and liquor; copy of a letter referenced during the initial appointment; payroll records to back up tips paid out; explanation and back up regarding the dancers' rental fees; explanation of where the private room rental fees charged to the dancers are deposited and how they are accounted for; information on the business that processes credit card sales, including name of business, business ID#; POS sales reports, invoices, receipts, and guest checks. For MLB, the second IDR also requested substantiation for chargebacks for the quarters ending May 31, 2012 and November 30, 2012.

28. On July 11, 2013, another field audit appointment was conducted for the audit of both Clubs. During this appointment, Mr. Capeci provided incomplete bank statements, incomplete purchase invoices for 2011, copies of promotional coupons, information regarding

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records for the expanded audit period.

the company that processes the credit card transactions (Metro), and copies of a transaction for a private room rental and a "funny money" purchase. Mr. Capeci had in his possession records of these transactions for October through December 2012, including Metro's receipts for each transaction. Additionally, the following records were at Mr. Capeci's office for review, but he would not allow the auditors to take the records from his office to review: register z-out tapes for the quarter ending May 31, 2012, rental contracts signed by dancers, and credit card transactions for room rentals and "funny money" from October through December, 2012.

29. By letter from Ms. Genovese to Mr. Capeci, dated July 24, 2013, the Division requested that petitioners provide numerous books and records that were still outstanding. The letter further stated, in part:

> "At our appointment on July 11, 2013, you had some z-out tapes available, dancer's contracts, and c/c transactions for 'funny money' and room charges all of which you requested be transcribed at your office. Since you will not allow these documents to be copied or removed from your office, please provide accommodations on August 15, 2013 for approximately 2-3 auditors for a full day."

30. Mr. Capeci subsequently canceled the appointment for August 15, 2013. By letter dated August 15, 2013, the Division sent Mr. Capeci a third IDR requesting the Clubs' outstanding books and records and stating again that:

> "At our appointment on July 11, 2013, you had some z-out tapes available, dancer's contracts, and c/c transactions for 'funny money' and room charges, all of which you requested be transcribed at your office. Since you will not allow these documents to be copied or removed from your office, please provide accommodations on September 19, 2013 for approximately 2-3 auditors for a full day."

Another field audit was conducted on September 19, 2013, and the Division's auditors transcribed the summary detail for front door, bar and room charges for the quarter ending May

31, 2012.

31. On August 15, 2013, Division's investigators conducted investigations of the Clubs. The investigators entered MLB's club at approximately 5:15 p.m. and were charged a $5.00 admission fee per person and were told there was a one drink minimum each. The investigators spoke with the Club's manager, Mario Barnes. The investigators inquired about a private party and asked if the party could pay the dancers directly. Mr. Barnes replied that, "No you don't have to pay them, we pay them." Mr. Barnes further informed the investigators that Lace dollars can be purchased at the front register if customers do not have cash, and that the Lace Dollars can be used to purchase drinks, lap dances, and be given as tips. The investigators were informed that there is free admission before 5:00 p.m., from 5:00 p.m. to 8:00 p.m. admission is $5.00, and after 8:00 p.m. admission is $20.00. The investigators were also informed that a lap dance in the main room is $20.00 per song, and a lap dance in a private room ranges from $160.00 to $900.00.

Other Division investigators entered 44th's club at approximately 5:15 p.m. on August 15, 2013. The doorman stated that admission was free with a one drink minimum per person. In the main room, the investigators observed dancers remove money that had been placed in their costumes and give it to a man who placed it in an envelope and left the room. The investigators were informed that lap dances were $20.00. The investigators spoke with the club's manager, Don, who informed them that small private rooms "go for anywhere between $300 and $1,100 per hour, it depends on amount of customers and how many girls are in the room at once."

32. On November 14, 2013, Ms. Scala and Ms. Genovese toured the Clubs with Mr. Capeci. The auditors noted that the Clubs had multiple private rooms in which the dancers

perform for patrons. During the tour, Mr. Capeci explained that Lace dollars can be purchased to pay for lap dances, the dancer's fee to go in a private room, and to tip employees.

33. On June 4, 2014, Mr. Capeci informed Ms. Genovese that he wanted to discuss the audits with her supervisors before they progressed any further, contending that the scrip sales were not subject to tax. In a letter from Mr. Capeci to Mario Scarpace, of the Division's Field Audit Management, dated July 24, 2014, Mr. Capeci stated, in part, that: "The underlying reason for operating the club in this fashion was to avoid law suits and employment tax issues in the future."[16] A telephone call was subsequently conducted between Mr. Scarpace, and Mr. Capeci, wherein Mr. Scarpace informed Mr. Capeci that the Clubs' receipts from the sales of private dances were subject to sales tax and that the Division was proceeding with the audits. In response, Mr. Capeci stated that on a previous audit he was not informed by the Division that the Clubs' business model was subject to tax, and that he would send a letter to the Division's Executive Deputy Commissioner, Nonie Manion, requesting a meeting.

34. By letter dated December 12, 2014, Mr. Capeci requested a meeting with Joe Carzo, Director of Audits. In response, a conference call was held between Joseph Vanderlinden of the Division's Field Audit Management, several other Division supervisors and employees, and Mr. Capeci. Mr. Vanderlinden explained that Mr. Carzo did not believe a meeting was necessary and that the Division was proceeding with the audits.

35. On September 17, 2015, Mr. Carzo, several employees from Field Audit Management, Ms. Genovese, Ms. Scala and their supervisors participated in a conference call

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[16] Similar to Mr. Capeci's explanation of the purpose behind the Clubs' business model, in Mr. Scarfi's affidavit in the ***Dennis*** matter, he described the "primary purpose" of Metro's business model as the scrip provider to the Clubs as being to "eliminate any implication that the scrip provider is . . . an 'employer' liable for compliance with the Fair Standards Act and New York Labor Law" (***see*** footnote 3).

with Mr. Capeci. During the call, the Division discussed the status of the audit, potential issues, the test of register tapes, private dances, customers' methods of payments, credit card processing and funny money. The call was concluded by agreeing that the audit team would resume audit activities and complete the review of available books and records. Mr. Capeci agreed to sign waivers extending the statute of limitations for expiring periods (waivers), and the Division agreed to have another discussion with Mr. Capeci before issuing assessments.

36. The Division subsequently sent the waivers to Mr. Capeci. Mr. Capeci signed the waivers and returned them with a letter dated September 25, 2015, in which he claimed that the Division's acceptance of the waivers validated his understanding that no further audit of the Clubs' private dances would be performed at the audit level and any further discussion of that matter would be held with the Division's executive personnel. By letter dated October 13, 2015, Mr. Carzo sent copies of the fully executed waivers to Mr. Capeci and responded to Mr. Capeci's correspondence by stating that the Division's endorsement of the waivers did not imply acceptance of his understanding or interpretation of the law or his business model.

37. On November 6, 2015, the Division sent a fourth IDR for the Clubs to Mr. Capeci, requesting outstanding records, as well as explanations and reconciliations for certain bank deposits and transfers shown in the Clubs' bank accounts. For MLB, the Division requested documentation on transfers of $973,748.94, credit card tips paid of $1,190,859.67, dancer fees (rent per the sales tax backup) of $3,968,808.00, and additional deposits of $2,927,114.43. For 44th, the Division requested documentation on transfers of $214,322.96, credit card tips paid out of $328,969.84, dancer fees (rent per the sales tax backup) of $1,389,160.80, and additional deposits of $2,038,093.72.

38. Another field audit appointment was conducted on November 23, 2015. On December 3, 2015, Ms. Genovese sent a letter to Mr. Capeci as a follow-up of the November 23, 2015 appointment, wherein she stated that to date, the Division had not received any of the documents requested in IDR number 4, and requested that he provide the documents by December 21, 2015.

39. On December 16, 2015, the Division sent letters and IDR number 5 to Mr. Capeci, expanding the audit period for the Clubs to include March 1, 2010 to February 28, 2014 and requesting books and records for the updated audit period. The letters scheduled a field audit appointment for the Clubs on January 28, 2016.

40. During the field audit appointment on January 28, 2016, Mr. Capeci provided some of the missing bank statements that were previously requested. Ms. Genovese noted in her audit log that when she asked Mr. Capeci for the missing bank statements, he responded, "Shhh . . . okay, I will pretend like I care." Mr. Capeci also provided the auditor with some "funny money" books with a log of the dancers who worked at the Clubs. The auditor determined that the logs were not sufficient to substantiate how many dancers worked at the Clubs or how much rent the Clubs received from the dancers. The auditor requested that Mr. Capeci allow her to take three of the funny money books to review and return to him at the end of the audit, but Mr. Capeci denied the request, stating, "No, they stay here." The auditor inquired about the difference between vouchers and "Lace $" as indicated in the books and Mr. Capeci stated there was no difference. When the auditor asked why they were broken out separately in the books, Mr. Capeci stated that she did not need to know. Ms. Genovese noted in her audit log that Mr. Capeci became agitated and began yelling and screaming at her during the appointment.

41. On January 29, 2016, Ms. Genovese discussed the January 28 field audit appointment with her supervisors and Field Audit Management. On February 1, 2016, Mr. Carzo and Mr. Vanderlinden called Mr. Capeci and left a voice message for him to return their call. On February 10, 2016, Mr. Vanderlinden called Mr. Capeci and stated that the Division was continuing with the audits of the Clubs and referred him to case law regarding the taxability of dance sales. During the call, Mr. Capeci referenced a letter from Deputy Commissioner Manion in which he claimed that the Division agreed his business model was not taxable. Mr. Vanderlinden replied that he would review the mentioned letter.

42. On February 24, 2016, Mr. Carzo and Mr. Vanderlinden called Mr. Capeci and left a detailed message that they had reviewed the correspondence he mentioned during the February 10 call, and that the letter only applied to the matter discussed in that correspondence and was for settlement purposes only. They further reiterated that the Division would be going forward with the audits.

43. On February 25, 2016, Ms. Genovese, together with Section Head Frank Grillo, called Mr. Capeci to discuss the audits and the requested records. Ms. Genovese faxed IDRs 4 and 5 to Mr. Capeci for his review. Mr. Capeci asked what part of the general ledger the Division wished to review and the auditors explained that they were requesting the general ledger for the entire audit period. Mr. Capeci inquired why they wanted the ledger for the entire period and the auditors explained that petitioners had no internal controls with the records currently provided. Ms. Genovese noted in her audit log that Mr. Capeci then stated that he needed to "clean up the general ledger for 2010 through 2014" because it was full of "mis-postings from the bookkeeper." Mr. Capeci also asked why the auditors wanted to see

purchase invoices and why they could not obtain them from third parties or the Division's database. The auditors explained that they needed petitioners' original source documents. Mr. Capeci suggested that the auditors look at records for 2012 or 2013, and that he preferred 2013.

44. On February 29, 2016, a call was held between Ms. Genovese, Ms. Scala, Mr. Grillo and Mr. Capeci to discuss Mr. Capeci's request that his response to the records request be postponed until after the tax season. The auditors explained that if they receive waivers from him extending the statute of limitations for the audit period of the Clubs, that they would allow additional time for the records to be provided. They also discussed scheduling an extraction of petitioners' electronic point of sales records with the Division's Technology Assist Audit (TAA) unit, and Mr. Capeci agreed.

45. On March 31, 2016, Ms. Genovese, Ms. Scala, and the TAA auditor went to the Clubs to attempt an extraction from the point of sale records. At MLB, the POS data available only went back to August 2015, which was after the audit period. The Club's manager stated that the system was upgraded and this was a new installation of software, but that he was sure the data was backed up before the new installation. The manager contacted the POS company, who later provided POS records for MLB for the period May 12, 2012 through February 28, 2014.

For 44th, the Division was unable to extract records from the POS system for the audit period, as the data only went back to August 2015. Petitioners and their POS company did not provide any point of sale records for 44th for the audit period.

46. On June 10, 2016, the Division's auditors again requested that Mr. Capeci provide the sales tax backup for the updated audit period, general ledgers for the entire audit period for both Clubs, and register tapes for the quarter ending November 30, 2013 to reconcile with the

POS records for MLB.

47. After reviewing the POS records provided for MLB, the auditors selected the sales tax quarter ending November 30, 2013 as a test period to determine if the club had reported the proper amount of tax. This period was chosen for the test period because the POS records from earlier periods were incomplete in that the gross sales reported on MLB's tax returns were substantially higher than the gross sales per the POS records provided. The quarter ending November 30, 2013 was the earliest quarter for which sales recorded in the POS were at least equal to the reported sales.

48. By letter dated June 16, 2016, the Division again requested that Mr. Capeci provide the outstanding records for the Clubs, as well as a written inventory of all records maintained and available during the audit period and all daily detailed sales records for the quarter ending November 30, 2013, and original source documents to substantiate certain deposits. The letter stated that the records were to be provided by June 28, 2016.

49. Mr. Capeci again requested an extension of time to provide the Clubs' records, but stated that he would provide the requested inventory by June 30, 2016. By letter dated June 27, 2016, the Division granted Mr. Capeci's request for an extension to July 14, 2016, and noted that as discussed, he would provide the requested inventory by June 30, 2016. Mr. Capeci did not provide the inventory, as stated, by June 30, 2016.

50. Another field appointment was conducted on July 14, 2016. The only records provided were sales invoices for the quarter ending November 30, 2013 for MLB. No records were provided for 44th. Mr. Capeci said that he was still working on the general ledgers and 44th's invoices for the quarter ending November 30, 2013 were not available.

51. By letter dated July 15, 2016, the Division requested that petitioners provide all the requested records that were still outstanding by July 21, 2016, and stated that no further postponements would be granted. The requested records were not provided by the established deadline.

52. On August 10, 2016, the Division sent letters to petitioners stating its intent to impose penalties on the Clubs for failing to provide books and records for the audit period.

53. The Division determined that petitioner MLB's records were not adequate because the summary paper POS, paper register tapes and credit card batch summaries provided by MLB were not detailed and not provided or maintained for every shift every day, there were no controls in place to ensure what was received was a recording of every transaction, and the electronic records provided for May 12, 2012 through the end of the audit period were incomplete, and did not reconcile to the paper receipts for the same periods nor to the taxpayer's reporting or bank deposits.

54. The Division determined that petitioner 44th's records were incomplete because the summary paper POS, paper register tapes and credit card batch summaries provided by 44th were not detailed and not provided or maintained for every shift every day, there were no controls in place to ensure what was received was a recording of every transaction, and the POS paper records did not reconcile to the taxpayer's reporting or the bank deposits.

55. To determine whether MLB had paid the proper amount of tax due for the audit period, the Division added the club's receipts from bar sales, door admissions, coat check and room rentals for the quarter ending November 2013 and determined audited gross receipts from those areas of $1,051,743.82 for that quarter. The club did not separately state sales tax on its

invoices. Therefore, to determine audited sales, the auditor subtracted tax remitted for that quarter ($59,575.92) from audited gross receipts and determined audited gross sales of $992,167.90 for the quarter. The auditor divided audited gross sales by gross sales reported by MLB for that quarter ($671,278.00) to determine an error rate of 1.478028328.[17] The auditor then multiplied gross sales reported in the amount of $8,790,452.00 by the error rate to determine audited gross sales of $12,992,537.09, additional gross sales of $4,202,085.09, and tax due of $372,935.05 for the period at issue from MLB's door admissions, coat check, bar sales and room rentals.

56. The Division also determined that MLB had an additional revenue stream from the sale of scrip and that tax was due from MLB on these sales. As stated in the Division's field audit report:

> "There was an additional revenue stream attributed to MLB Enterprises maintained by a related company Metro Enterprises. Metro Enterprises sells script [sic] to patrons who wish to use their credit card rather than cash when purchasing a lap dance and/or private dance. Metro Enterprises has a dedicated credit card terminal in MLB's club and the receipts are deposited into a dedicated bank account for MLB Enterprises. The credit card terminal is operated by MLB's employees and not reported by MLB Enterprises. The receipts were deemed receipts from the operation of an adult entertainment establishment."

To determine the tax due on scrip sales at MLB, the auditor computed additional taxable sales from scrip sales based on deposits attributed to MLB for the period in issue in the amount of $16,058,292.71 and determined additional tax due from MLB on these sales in the amount of $1,425,173.48.

57. In total, the Division determined that for the period at issue, MLB had additional taxable sales of $20,260,377.79 and owed sales tax in the amount of $1,798,108.53 plus penalties

[17] The determination erroneously indicates that the error rate was 1.47%. The audit report and the

and interest.

58. The Division issued two notices of determination to MLB. Notice of determination L-045789856, dated November 30, 2016, assessed additional tax of $1,798,108.53 plus penalties and interest. Notice of determination L-045790014, dated November 30, 2016, asserted penalties in the amount of $86,000.00 for MLB's failure to produce books and records for the audit period.

59. To determine whether 44th had paid the proper amount of tax due for the period in issue, the Division added the club's receipts from bar sales, door admissions, coat check and room rentals for the quarter ending November 2013 and determined audited gross receipts from those areas of $662,326.08 for that quarter. To determine audited sales, the auditor subtracted tax remitted for that quarter ($40,622.65) from audited gross receipts and determined audited gross sales of $621,703.43 for that quarter. The auditor divided audited gross sales by gross sales reported by 44th for that quarter ($457,720.00) to determine an error rate of 1.358261448.[18] The auditor multiplied gross sales reported ($4,698,853.00) by the error rate to determine audited gross sales of $6,382,270.89 and additional gross sales of $1,683,417.89 for the period in issue from door admissions, coat check, bar sales and room rentals. The auditor then multiplied $1,683,417.89 by the tax rate to determine additional tax due from 44th of $149,403.32 from these sales.

60. The Division also determined that 44th had an additional revenue stream from the sale of scrip and that tax was due from 44th on these sales. As stated in the Division's field audit report:

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computations therein show the correct error rate.

[18] The determination erroneously indicates that the error rate was 1.35%. The audit report and

> "There was an additional revenue stream attributed to 44th Enterprises maintained by a related company Metro Enterprises. Metro Enterprises sells script [sic] to patrons who wish to use their credit card rather than cash when purchasing a lap dance and/or private dance. Metro Enterprises has a dedicated credit card terminal in 44th's club and the receipts are deposited into a dedicated bank account for 44th Enterprises. The credit card terminal is operated by 44th's employees and not reported by 44th Enterprises. The receipts were deemed receipts from the operation of an adult entertainment establishment."

To determine the tax due on scrip sales at 44th, the auditor computed additional taxable sales from scrip sales based on deposits attributed to 44th for the period in issue in the amount of $3,969,528.78 and determined additional tax due from 44th on these sales in the amount of $352,295.67.

61. In total, the Division determined that for the period at issue, 44th had additional taxable sales of $5,652,946.67 and owed additional tax of $501,699.02 plus penalties and interest.[19]

62. The Division issued two notices of determination to 44th. Notice of determination L-045789743, dated November 30, 2016, assessed additional tax of $501,699.02 plus penalties and interest. Notice of determination L-045789538, dated November 30, 2016, asserted penalties in the amount of $156,000.00 for 44th's failure to produce books and records for the audit period.

63. The auditors did not interview any dancers from the Clubs or observe any scrip exchanges or redemptions in the Clubs. Petitioners did not present testimony from any of the Clubs' dancers.

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computations therein show the correct error rate.

[19] It is noted that the total of tax determined due from door admission, coat check, bar sales, and room rentals of $149,403.32 plus tax determined due from scrip sales of $352,295.67 equals $501,698.99 rather than $501,699.02 as stated in the field audit report and notice of determination. There was no explanation for the discrepancy. Such difference, nevertheless, is deemed inconsequential.

64. A hearing for this matter took place on January 29, 2020. The following witnesses testified at the hearing: Mr. Capeci, Mr. Scarfi, Ms. Bux, Ms. Scala, and Mr. Carzo.

65. During the hearing, petitioners requested that two boxes of documents they described as ledgers, and marked as exhibits 42 and 43, be admitted into the record. Petitioners did not have copies of the documents and did not provide copies for the Division. The Administrative Law Judge instructed petitioners that they were required to make copies of any documents introduced into the record and that they were required to provide the Division with a set. Later during the hearing, petitioners' representative acknowledged that they "will work on getting a full copy made and have another copy ready for Mr. Jack or whoever else needs a full copy of the records." The exhibits were accepted into the record on the contingency that petitioners were going to make copies.

66. At the hearing's conclusion, the Administrative Law Judge advised the parties the record would be closed, and the following dialogue occurred:

> "Judge Russo: [O]nce I close the record today, nothing further will be accepted. I know we are waiting for copies of Exhibits 42 and 43, so if we conclude today and don't come back tomorrow, what I will do is I'm not going to take them in at this time since you need to make the copies. I'll hold the record open for a date certain for you to make the copies and sent [sic] them to me and Mr. Jack.
>
> Mr. Shertzer: Your Honor, are you going to want us to send you the originals or is a copy okay?
>
> Judge Russo: We are allowed to take copies, but make sure they're legible because if they're not legible they are going to be useless to me.
>
> Mr. Shertzer: Sure, understood."

The Administrative Law Judge established February 12, 2020 as petitioners' deadline to provide exhibits 42 and 43 to the Division of Tax Appeals and to the Division's representative,

Mr. Jack.

The Administrative Law Judge again stated, "As I stated previously, once I close the record, nothing further will be accepted other than Exhibits 42 and 43 which I held the record open for" and further, "As I was saying, once I close the record, nothing further will be accepted. With that in mind, Mr. Shertzer, do you have anything further for the petitioner?" Petitioners' representative, Mr. Shertzer responded, "No, Your Honor." After the hearing, petitioners sent copies of exhibits 42 and 43 within the time allowed.

67. Following the February 18, 2021 issuance of the determination, petitioners brought a motion to reopen the record or for reargument on April 12, 2021. By their motion, petitioners sought to introduce additional evidence into the record, consisting of an affidavit of Mr. Scarfi, dated April 6, 2021, and an affirmation of Jennifer M. Kinsley, Esq., dated April 11, 2021. Ms. Kinsley is an attorney who has represented Mr. Capeci before the Division of Tax Appeals. The affidavit and affirmation purport to offer observations and insights regarding petitioners' exhibits 42 and 43.

68. Petitioners timely requested an extension of time to file their exception to the February 28, 2021 determination. Given the pending motion to reopen, the Secretary to the Tax Appeals Tribunal held the commencement of the 30-day period for the filing of petitioners' exception in abeyance until the order on that motion was issued. The Administrative Law Judge's order denying the motion was issued on August 5, 2021 and petitioners timely filed their exception to both the determination and the order on or about September 3, 2021.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge found that scrip sold at the Clubs was used by customers

to purchase dances, private room rentals and drinks. She further determined that the sale of scrip to purchase exotic dances, including a room rental for a private dance, at an adult entertainment club is subject to sales tax as an admission or amusement charge to a place of amusement pursuant to Tax Law § 1105 (f) (1). The Administrative Law Judge rejected petitioners' contention that they were relieved of responsibility to collect and pay sales tax because the scrip transactions were processed through Metro's credit card terminals. The Administrative Law Judge reasoned that, as petitioners offered dances to their customers, offered scrip by which such dances could be purchased, sold scrip through their employees, set minimum prices for dances, and derived revenue from the scrip from room charges and fees collected from dancers, petitioners were responsible for the collection and payment of sales tax on the scrip transactions.

The Administrative Law Judge also determined that the sale of scrip at the Clubs was taxable pursuant to Tax Law § 1105 (f) (3) as "[t]he amount paid as charges of a roof garden, cabaret or other similar place in the state." In support, the Administrative Law Judge cited case law that reached a similar conclusion with respect to scrip sales at an adult entertainment club and dismissed petitioners' efforts to distinguish such precedent.

The Administrative Law Judge further determined that petitioners' charges for beverages, cover, minimum, entertainment, and other charges, including charges for the sale of scrip at the Clubs were taxable pursuant to Tax Law § 1105 (d), which imposes tax on restaurant sales of food and drink and includes the receipts from any cover, minimum, entertainment or other charge made to customers. Contrary to petitioners' contention, the Administrative Law Judge found that scrip was used to purchase private rooms and beverages, as well as dances, and that

petitioners failed to show what portion of the scrip was used for nontaxable purposes. She thus concluded that the sale of scrip was alternatively taxable under this provision.

The Administrative Law Judge rejected petitioners' contention that the scrip was not subject to sales tax because it was solely used for voluntary gratuities. The Administrative Law Judge determined that the scrip was used to purchase dances and that testimony to the contrary lacked credibility. The Administrative Law Judge also determined that the ledger books (***see*** finding of fact 21) did not support petitioners' claim that the full amount of scrip purchased by customers was redeemed by the dancers. Additionally, the Administrative Law Judge found that petitioners set prices for the dances and that this fact contradicted petitioners' claim that they did not sell dances and their corresponding claim that customer payments for such dances were voluntary gratuities. The Administrative Law Judge thus concluded that petitioners failed to overcome Tax Law § 1132 (c)'s presumption of taxability with respect to scrip sales.

The Administrative Law Judge dismissed as meritless petitioners' reliance on New York Labor Law and the federal Fair Labor Standards Act (FLSA) in support of their argument that that the scrip was used only for voluntary gratuities. The Administrative Law Judge found that this argument rested on the claim that the scrip was used only to pay gratuities to the dancers and that petitioners did not retain any of the scrip proceeds. The Administrative Law Judge determined that petitioners failed to prove either of these contentions. The Administrative Law Judge also noted that petitioners structured their businesses to avoid employment tax issues and labor law obligations. She observed that this structure should not be used to avoid petitioners' sales tax obligations.

The Administrative Law Judge next addressed whether petitioners were persons

responsible to collect and remit sales tax pursuant to Tax Law § 1131 (1). The Administrative Law Judge found that petitioners, through their employees, sold scrip to customers, collected the receipts, exchanged the scrip for the customers' credit card payments, created book entries to record the sales, and redeemed the scrip by exchanging it for cash. The Administrative Law Judge determined that, since scrip sales to purchase dances and to make other purchases are amusement and admission charges, petitioners were the recipients of amusement charges and were thus persons required to collect tax on such charges pursuant to Tax Law § 1131 (1). The Administrative Law Judge also determined that petitioners were persons required to collect and remit sales tax as vendors because they made taxable sales of entrance admissions, beverages, dances, access to private rooms, and scrip.

The Administrative Law Judge rejected petitioners' argument that they were not responsible for the collection and payment of sales tax on scrip sales because those transactions were run on Metro's credit card terminals and receipts from those transactions were deposited in Metro's bank account. The Administrative Law Judge determined that the use of a third party to manage and collect receipts does not affect the basis for the imposition of the tax. The Administrative Law Judge also found that petitioners and Metro commingled accounts and transactions by using each other's credit card terminals, noting that charges processed by Metro included transactions for the Clubs' room rentals. The Administrative Law Judge further noted that Mr. Capeci had and exercised check signing authority for Metro and that Mr. Scarfi had and exercised check signing authority for MLB and 44th.

The Administrative Law Judge determined that petitioners failed to meet their burden of proving that the Division's determination of additional tax due on their receipts from sales of

door admissions, coat check, room rentals and beverages was erroneous. The Administrative Law Judge found that petitioners failed to produce books and records sufficient to verify their reported taxable sales and that, accordingly, the Division was entitled to estimate petitioners' sales tax liability based on the information available. As determined by the Administrative Law Judge, under such circumstances, petitioners bore the burden of establishing that the audit method employed was unreasonable or that the results of the audit were erroneous. The Administrative Law Judge concluded that petitioners failed to meet this burden. The Administrative Law Judge rejected petitioners' contention that the Division erroneously included room rentals in taxable sales. Rather, the Administrative Law Judge found that petitioners did not show that rooms could be rented without an accompanying dancer. The Administrative Law Judge characterized Mr. Capeci's testimony on this point as "incredible." Even if some rooms were rented without a dancer, the Administrative Law Judge determined that petitioners presented no evidence to distinguish between room rentals with a dancer and room rentals without a dancer.

The Administrative Law Judge rejected petitioner's argument that the Division should be estopped from assessing sales tax against them for the period at issue because they detrimentally relied on the results of prior audits and prior statements made by the Division. The Administrative Law Judge found that results from prior audits are not binding on later audits.

The Administrative Law Judge also rejected petitioners' contention that the Division violated the State Administrative Procedure Act by adopting a policy that scrip sales are always subject to sales tax. The Administrative Law Judge determined that the Division did not have such a policy.

The Administrative Law Judge dismissed petitioners' contention that the assessments violate their due process rights under the federal and state constitutions by making it impossible for petitioners to comply with both the tax laws and labor laws. The Administrative Law Judge found that this assertion was premised on petitioners' "groundless" assertion that the scrip was paid to the dancers as voluntary gratuities. The Administrative Law Judge also found that petitioners failed to show that they were treated by the Division differently than any similarly situated taxpayer.

Finally, the Administrative Law Judge sustained the Division's assertion of penalties. She found that petitioners did not provide all records that were requested and those that were provided were incomplete. She also found that petitioners presented no evidence to show that their failure to properly report and pay over sales tax was due to reasonable cause and not due to willful neglect. The Administrative Law Judge also noted that Mr. Capeci was often uncooperative and at times belligerent during the audit.

THE ORDER OF THE ADMINISTRATIVE LAW JUDGE ON MOTION TO REOPEN

The Administrative Law Judge denied petitioners' motion to reopen the record as untimely because it was brought more than 30 days after the issuance of the determination, contrary to the Rules of Practice and Procedure of the Tax Appeals Tribunal (Rules of Practice and Procedure or Rules) (***see*** 20 NYCRR 3000.0 et seq.). The Administrative Law Judge further found that such 30-day time limit was not subject to an extension, even for good cause. Even if it was, the Administrative Law Judge found that petitioners failed to establish any such good cause here. The Administrative Law Judge also addressed the merits of the motion and found that petitioners failed to show that the evidence that they seek to introduce by their motion

met the requirements of the relevant regulations. Specifically, the Administrative Law Judge found that petitioners failed to show that such evidence was newly discovered, would probably have produced a different result, and could not have been discovered with the exercise of reasonable diligence in time to be offered into the record.

ARGUMENTS ON EXCEPTION

Determination

Citing ***Metro Enters. Corp. v New York State Dept. of Taxation & Fin.*** (171 AD3d 1377 [3d Dept 2019]), petitioners assert that whether the sale of scrip in an adult entertainment nightclub is subject to sales tax requires a fact-specific inquiry that analyzes the relationship between the scrip issuer, the dancers, and the nightclub. Petitioners contend that no such analysis was conducted here. Petitioners argue that the Administrative Law Judge erred by failing to find that the dancers were employees of the clubs and further erred by failing to address the legal implications of the dancers' status as employees. Petitioners contend that, under New York Labor Law and the FLSA, scrip vouchers paid by customers directly to petitioners' dancers and retained by the dancers must be presumed to be voluntary gratuities when, as here, the dancers are employees. As gratuities, petitioners contend, the scrip transactions were not subject to sales tax. Petitioners note that the scrip transactions were not recorded in either petitioner's gross receipts. Petitioners assert that the scrip ledgers in evidence show that scrip vouchers were redeemed into cash and kept by the dancers. According to petitioners, the Division's failure to consider the scrip ledgers during the audit was compounded by the Administrative Law Judge's erroneous and improper analysis of the ledgers. Petitioners contend that the Administrative Law Judge made erroneous factual findings with respect to the

ledgers and that petitioners have been unable to respond to such erroneous findings because they were raised for the first time in the determination.

Petitioners also assert that the Administrative Law Judge wrongly affirmed the Division's use of Metro's bank deposits to determine their sales tax liability. Petitioners stress that they are separate and distinct entities from Metro with no common ownership, officers or employees and that Metro was solely responsible for all aspects of the scrip transactions in the Clubs. Petitioners contend that their employees' assistance in the scrip transactions is irrelevant because, according to petitioners, the money from the scrip transactions came exclusively from Metro and all proceeds from the transactions went to Metro and the dancers. Petitioners emphasize that money from the scrip transactions did not enter petitioners' revenue streams. Petitioners also contend that the Administrative Law Judge wrongly determined that petitioners and Metro comingled accounts. Petitioners contend that their credit card terminals were used for scrip transactions only if Metro's terminals were not working.

Petitioners argue that the circumstances in the present matter, especially that Metro is a separate business with a separate owner and that petitioners did not include any part of the scrip transactions in their gross receipts, distinguishes the present matter from other cases where sales of scrip for the purchase of exotic dances were determined to be taxable.

Petitioners also contend that their room rentals are not subject to sales tax. Unlike other cases where room rentals in an adult entertainment club were determined to be taxable, petitioners assert that their room rentals were not associated with any other charge subject to sales tax and, also, that such rentals were separately listed in petitioners' records.

As they did below, petitioners assert that the Division should be estopped from assessing

sales tax against them for the period at issue. Petitioners contend that the Division did not subject scrip transactions to sales tax either during previous audits of the Clubs or during previous audits of Metro and another adult entertainment club owned by Mr. Capeci. Petitioners assert that it was reasonable for them to rely on statements made by the Division during those prior audits and that they did so to their detriment.

Related to their estoppel argument, petitioners assert that the Division failed to provide them with notice or an explanation of the Division's assertedly changed position on the taxability of scrip transactions following the prior audits. Petitioners assert that it is unfair to subject them to sales tax liability on such transactions under these circumstances.

Petitioners argue that the Division's auditors adopted a general policy that all scrip transactions in adult entertainment clubs are subject to sales tax and that the Division failed to follow the requirements of the State Administrative Procedure Act in adopting this policy. Accordingly, petitioners assert that the policy should be deemed invalid, and the assessments based thereon should be canceled.

Petitioners also contend that the assessment of tax on the scrip transactions violated their due process rights. Petitioners assert that the audit was deficient and that the issuance of assessments based on such an audit does not comport with the requirements of due process. Petitioners also assert that the assessments violate their due process rights by making it "impossible" for petitioners to comply with both the Tax Law and the relevant labor laws. Specifically, petitioners assert that the same receipts, i.e., the scrip redeemed and retained by the dancers, determined to be gratuities under the labor laws have been determined by the Division to be receipts subject to sales tax and payable by petitioners. Petitioners assert that such

"inconsistent" treatment is unconstitutional.

Petitioners further contend that, to the extent that the assessments render petitioners liable for sales tax on monies that they never retained, the assessment deprives petitioners of their constitutional property rights.

Finally, petitioners contend that penalties imposed herein should be canceled because the assessments of sales tax should be canceled.

The Division agrees with the Administrative Law Judge's conclusion that the sales of scrip were subject to tax under Tax Law § 1105 (f) (1), (f) (3) and (d). In opposition to petitioners' arguments on exception, the Division asserts that the Administrative Law Judge did not determine that all scrip transactions are taxable, but rather applied the correct legal standard and concluded that petitioners did not establish what amount of scrip was used for nontaxable purposes. The Division also asserts that the Administrative Law Judge correctly determined that the evidence shows that scrip was used to pay required amounts for dances and certain other purchases, none of which are properly considered tips, and that petitioners have not established the amount of scrip that was paid to the dancers as tips. According to the Division, petitioners' argument that the determination fails to address the legal implications of the dancers' status as employees misses the point. The Division contends that, whether the dancers were employees or not, receipts from sales of scrip used to pay for dances are properly subject to tax. As to the scrip ledgers, the Division concurs with the Administrative Law Judge's finding that such documents fail to establish the amounts paid to the dancers as gratuities.

The Division also agrees with the Administrative Law Judge's finding that petitioners are the recipients of amusement charges and are thus persons required to collect tax on such charges

under Tax Law § 1131 (1). The Division further agrees with the Administrative Law Judge's finding that petitioners are also vendors required to collect tax under Tax Law § 1131 (1).

The Division also agrees with the Administrative Law Judge's conclusion that petitioners' room rentals were taxable. The Division notes that room rentals to provide private dances in an adult entertainment club are subject to sales tax and contends that petitioners have not identified any specific room rentals that were not associated with a private dance.

The Division concurs with the Administrative Law Judge's rejection of petitioners' estoppel claim and her rejection of petitioners' claim that the Division adopted a policy that all scrip sales are taxable.

The Division asserts that petitioners' constitutional claims are baseless. The Division agrees with the Administrative Law Judge's conclusion that petitioners have not shown that they were treated differently than other similarly situated taxpayers.

Finally, the Division also agrees with the Administrative Law Judge's conclusion that petitioners have failed to show reasonable cause for the abatement of penalties.

Order Denying Motion to Reopen

With respect to their exception to the order denying their motion to reopen the record, petitioners assert that the scrip ledgers serve a central role in petitioners' case in this matter and that the Administrative Law Judge raised new factual issues regarding the scrip ledgers in the determination. Petitioners assert that a full and complete analysis of the scrip ledgers is critical to its case. As to the timeliness of its motion, petitioners contend that they made substantial efforts to bring the motion as soon as practicable under the circumstances. They assert that, at the time the determination was issued in February 2021, their counsel was ineligible for the

COVID-19 vaccine and was unable to travel or to safely access the scrip ledgers. They thus contend that good cause exists to consider the motion, which was filed beyond the 30-day time limit in the Rules of Practice and Procedure.

The Division asserts that the Administrative Law Judge correctly denied petitioners' motion to reopen for the reasons stated in the order.

OPINION

Order of the Administrative Law Judge

As relevant here, our Rules of Practice and Procedure provide that the Administrative Law Judge may, upon motion by a party, issue an order vacating the determination and reopening the record upon the grounds of "newly discovered evidence which, if introduced into the record, would probably have produced a different result and which could not have been discovered with the exercise of reasonable diligence in time to be offered into the record of the proceeding" (20 NYCRR 3000.16 [a] [1]). Such a motion "shall be made to the administrative law judge . . . within 30 days after the determination has been served" (20 NYCRR 3000.16 [b]).

Petitioners' motion to reopen was filed 53 days after the issuance of the determination (***see*** finding of fact 67) and was thus not brought within the 30-day time limit set forth in the Rules. As noted, petitioners assert that travel difficulties caused by the COVID-19 pandemic caused the motion's late filing. They argue that such problems constitute good cause and that principles of basic fairness require that their failure to timely file their motion be excused.

We sympathize with travel problems brought on by the pandemic. Furthermore, we disagree with the Administrative Law Judge's finding that our Rules preclude an extension of the 30-day period to file a motion to reopen for good cause (***see*** 20 NYCRR 3000.23 [b]

[administrative law judges may grant an extension of time for good cause provided no statutory prohibition exists]).[20] We do not find, however, that the Administrative Law Judge improperly denied petitioners' motion to reopen the record as untimely. Petitioners' motion was 23 days late and they did not request an extension of time to file. Their asserted COVID-19-related travel difficulties are not a reasonable excuse for their failure to timely request an extension of time to file their motion. Accordingly, the Administrative Law Judge's rejection of the motion as untimely was reasonable.

Even if petitioners' motion to reopen was considered timely, their motion would be properly denied on the merits. As noted, the Rules limit motions to reopen to the grounds of newly discovered evidence (20 NYCRR 3000.16 [a] [1]). Newly discovered evidence means evidence that was in existence but undiscoverable with due diligence at the time of the hearing (***Matter of Frenette***, Tax Appeals Tribunal, February 1, 2001, citing ***Matter of Commercial Structures v City of Syracuse*** (97 AD2d 965, 966 [4th Dept 1983]).

Here, the evidence that petitioners sought to admit into the record by their motion, the Scarfi affidavit and Kinsley affirmation, did not exist at the time the determination was issued; it was created thereafter. These documents were thus not newly discovered evidence within the meaning of the Rules and petitioners' motion to reopen the record is properly denied on this basis as well.

Petitioners do not contend that the Scarfi affidavit and Kinsley affirmation were newly discovered, but rather argue that the motion to reopen is necessary because the Administrative Law Judge raised new factual issues in the determination. The new factual issues to which petitioners refer are the facts drawn from the Administrative Law Judge's review of their ledger

[20] Although we find that the 30-day period may be extended for good cause, we emphasize that "[a]n administrative law judge shall have no power to grant [such] a motion . . . after the filing of an exception with the

books (***see*** finding of fact 21). Petitioners contend that these facts do not accurately reflect the ledger books. Petitioners thus seek to use a motion to reopen to introduce additional evidence because the evidence offered at the hearing resulted in unfavorable factual findings. This is not the function of a motion to reopen (***see Carota v Wu***, 284 AD2d 614, 617 [3d Dept 2001] quoting ***Matter of Beiny***, 132 AD2d 190, 210 [1st Dept 1987], ***lv dismissed*** 71 NY2d 994 [1988] [a motion for "renewal 'is not a second chance freely given to parties who have not exercised due diligence in making their first factual presentation'"]). Petitioners could have offered testimony or other evidence at the hearing to further explain the ledger books, but did not.

Finally, as the following discussion makes clear, even if the proposed new evidence was considered newly discovered, such evidence would not "probably have produced a different result," as required for success on such a motion (20 NYCRR 3000.16 [a] [1]).

Determination of the Administrative Law Judge

Tax Law § 1105 (f) (1) imposes sales tax on, generally, "any admission charge . . . to or for the use of any place of amusement in the state." An admission charge is "the amount paid for admission, including any service charge and any charge for entertainment or amusement or the use of facilities therefor" (Tax Law § 1101 [d] [2]). A place of amusement is "any place where any facilities for entertainment, amusement or sports are provided" (Tax Law § 1101 [d] [10]).

Tax Law § 1105 (f) (3) imposes sales tax on "the amount paid as charges of a roof garden, cabaret or other similar place in the state." A charge of a roof garden, cabaret or other similar place includes "[a]ny charge made for admission . . . or entertainment . . . at [such a place]" (20 NYCRR 527.12 [b] [1]). A roof garden, cabaret or other similar place is, generally, any such place "which furnishes a public performance for profit" (Tax Law § 1101 [d] [12]).

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tax appeals tribunal" (20 NYCRR 3000.16 [b]).

Receipts from sales of drinks in a bar are subject to sales tax under Tax Law § 1105 (d). Liability under Tax Law § 1105 (d) also includes receipts from any "cover, minimum, entertainment or other charge made to patrons or customers."

A charge for a lap dance or a private dance at an adult entertainment establishment is subject to sales tax both as an admission charge for the use of a place of amusement pursuant to Tax Law § 1105 (f) (1) and as a charge of a roof garden, cabaret or other similar place pursuant to Tax Law § 1105 (f) (3) (***Matter of Gans v New York State Tax Appeals Trib.***, 194 AD3d 1209, 1211 [3d Dept 2021]; ***Matter of HDV Manhattan, LLC v Tax Appeals Trib. of the State of N.Y.***, 156 AD3d 963, 965-966 [3d Dept 2017]; ***Matter of 677 New Loudon Corp. v State of N.Y. Tax Appeals Trib.***, 85 AD3d 1341 [2011], ***affd*** 19 NY3d 1058 [2012], ***reargument denied*** 20 NY3d 1024 [2013], ***cert denied*** 571 US 952 [2013]; ***Matter of Greystoke Indus.***, Tax Appeals Tribunal, May 19, 2011; ***Matter of Marchello***, Tax Appeals Tribunal, April 14, 2011).

A separate charge for access to a private room in an adult entertainment club is also subject to sales tax pursuant to Tax Law § 1105 (f) (1) and (3) where the private room is to be used for a private dance (***Matter of HDV Manhattan, LLC v Tax Appeals Trib. of the State of N.Y.***; ***Matter of The Executive Club LLC***, Tax Appeals Tribunal, April 19, 2017).

Scrip sales in an adult entertainment club are subject to sales tax where such scrip is used by customers to pay charges for admission, amusement, or entertainment taxable pursuant to Tax Law § 1105 (f) (1) and (3) (***Matter of Gans v New York State Tax Appeals Trib.***, 194 AD3d at 1211; ***Matter of HDV Manhattan, LLC v Tax Appeals Trib. of the State of N.Y.***, 156 AD3d at 965; ***Matter of Marchello***; ***see also Metro Enters. Corp. v New York State Dept. of Taxation & Fin.***, 171 AD3d at 1377, 1380 [3rd Dept 2019]). Sales tax is collectable on such scrip sales at the time the customer purchases the scrip (***Matter of Executive Club, LLC***, Tax Appeals Tribunal, July 24, 2019, ***confirmed sub nom Gans v New York State Tax Appeals Trib.***).

Private dance charges at an adult entertainment club are alternatively taxable under Tax Law § 1105 (d) (***Matter of 677 New Loudon Corp. d/b/a Nite Moves***, Tax Appeals Tribunal, April 14, 2010, ***affd on other grounds Matter of 677 New Loudon Corp. v State of N.Y. Tax Appeals Trib.***).

All charges of any type mentioned in Tax Law § 1105 (f) and receipts under Tax Law § 1105 (d) are presumptively subject to tax until the contrary is established and the burden of proving that any such charge or receipt is not taxable is upon the person required to collect or the customer (Tax Law § 1132 [c] [1]). Persons required to collect tax include every recipient of amusement charges (Tax Law § 1131 [1]).

Petitioners do not take issue with the foregoing principles. Rather, petitioners argue that the present circumstances are distinguishable and that the Division erroneously asserted additional tax due in the present matter. We disagree.

We note first that petitioners' reliance on ***Metro Enters. Corp. v New York State Dept. of Taxation & Fin.*** as the standard for determining the taxability of the subject scrip transactions is misplaced. That case involved a declaratory judgment action brought by Metro and Mr. Scarfi against the Division by which Metro contested the Division's assertion of sales tax liability on sales of scrip used to pay for private dances at adult entertainment clubs, similar to the present circumstances. The court agreed with the Division that there were many factual questions regarding "the relationship between plaintiffs, the dancers and the registered clubs" and that, accordingly, the court was unable to determine the extent to which Metro's receipts were taxable (171 AD3d at 1380). As such, the court found that Metro and Mr. Scarfi failed to exhaust their administrative remedies and dismissed the complaint (***id.***). From ***Metro***, petitioners extrapolate the proposition that scrip transactions in an adult nightclub are not necessarily subject to sales tax, but that the taxability of such transactions depends on the relationship between the scrip

issuer, the dancers, and the clubs. This overstates ***Metro***'s holding. The issue in ***Metro*** was whether a third-party scrip issuer was liable for sales tax on scrip transactions in a strip club. ***Metro*** finds that such liability depends on the relationship between the scrip issuer and the other parties. ***Metro*** does not purport to address the issue presented here, that is, whether *the clubs* are liable for sales tax on scrip transactions. Indeed, the decision notes with approval the well-established principles that any charge by a club that offers exotic dancing is subject to sales tax and that receipts from the sale of scrip are taxable when the scrip is used to pay for a private dance at such a club (171 AD3d at 1380 citing ***Matter of 677 New Loudon Corp. d/b/a Nite Moves v State of New York Tax Appeals Tribunal*** [85 AD3d at 1346] and ***Matter of HDV Manhattan, LLC v Tax Appeals Trib. of the State of N.Y.*** [156 AD3d at 966]). ***Metro*** thus does not support petitioners' position.

We also reject petitioners' contention that the taxability of the subject scrip transactions turns on the existence of an employment relationship between petitioners and the dancers.

On this point, we note first our disagreement with petitioners' contention that the Administrative Law Judge failed to find that the dancers were employees of the clubs. The findings of fact on this point reflect the reality that petitioners considered the dancers to be independent contractors (or tenants) until litigation by the dancers apparently compelled them to change their position (***see*** findings of fact 4 and 9 and footnote 3). The Administrative Law Judge's discussion of petitioners' New York Labor Law and FLSA argument clearly presumes that the dancers were employees.

We have previously determined that charges for private dances in an adult entertainment club were subject to sales tax where the dancers were classified as independent contractors (***e.g.***, ***Matter of HDV Manhattan, LLC***, Tax Appeals Tribunal, February 12, 2016, ***confirmed*** 156 AD3d 963) and as employees (***Matter of 677 New Loudon Corp. d/b/a Nite Moves***, Tax Appeals

Tribunal, August 25, 2016). We have not previously addressed petitioners' argument, which suggests that the amounts paid to the dancers for dances must be considered voluntary gratuities *because* the dancers were employees. As petitioners correctly observe, voluntary gratuities are generally not subject to sales tax (***see*** TSB-M-09[13]S ["Sales Tax on Gratuities and Service Charges"] [August 4, 2009]). This is because voluntary gratuities are not properly included in the receipt for property or services taxable under Tax Law § 1105 (a) or (c) or the charge taxable under Tax Law § 1105 (f).

The record clearly shows, however, that the amounts that customers paid to the dancers were not voluntary. Customers were required to pay, at minimum, a set price to receive a dance. Petitioners set the minimum price for private dances on the main floor of the clubs at $20.00 per song and dances in the private rooms ranged from either $160.00 to $900.00 or $300.00 to $1,100.00 per hour (***see*** findings of fact 7 and 13). These amounts were thus charges for entertainment or amusement under Tax Law § 1101 (d) (2) and 20 NYCRR 527.12 (b) (1). Obviously, some customers may have paid dancers an amount greater than the set price. Such an excess amount could be construed as a voluntary gratuity, not subject to sales tax (***see*** TSB-M-09[13]S). However, there is no evidence in the record of any such payments. The amounts paid by petitioners' customers to the dancers for lap dances and private dances were thus charges for purposes of Tax Law § 1105 (f).

In making our finding regarding dance prices, we note our rejection of Mr. Capeci's testimony that there was no fixed price for dances and that the dancers would negotiate the price for a personal dance (***see*** finding of fact 13). We do so based on the Administrative Law Judge's characterization of Mr. Capeci's testimony as "incredible" and her characterization of the testimony of petitioners' witnesses as lacking in credibility (***see Matter of Majestic Deli Grocery, Inc.***, Tax Appeals Tribunal, April 14, 2017 [Tribunal generally defers to witness

credibility determination of the Administrative Law Judge]). Furthermore, even if the price for a dance was negotiated between the dancer and customer, the amount required to be paid for a dance would constitute a charge subject to tax under Tax Law § 1105 (f) (1) and (3).

Petitioners also argue that even mandatory charges paid by a customer directly to an employee are properly considered gratuities pursuant to New York Labor Law and the FLSA where the customer reasonably believes such payments will be retained by the employee and where such payments do not become part of the employer's gross receipts. In support, petitioners cite ***Hart v Rick's Cabaret Intl. Inc.*** (60 F Supp 3d 447 [SDNY 2014]), a case involving alleged violations of New York Labor Law and the FLSA, where the court found that scrip payments made by customers to dancers in an adult entertainment club should be seen as "gratuities belonging to the dancer, not as service charges belonging to the Club" (60 F Supp 3d at 457). Petitioners note that the scrip payments to the dancers did not become part of their gross receipts and assert, accordingly, that such payments, even if mandatory, must be treated as nontaxable gratuities. Petitioners also note that Labor Law § 196-d prohibits employers from demanding, accepting or retaining, directly or indirectly, any part of an employee's gratuity or any charge purported to be a gratuity. Petitioners further contend that amounts paid directly to an employee are properly presumed to be gratuities under Labor Law regulations (***see*** 12 NYCRR 146-2.18).

Petitioners thus argue that the FSLA and New York Labor Law control for purposes of determining whether payments for dances are nontaxable gratuities or taxable charges. We disagree. As discussed, the amounts paid by customers to the dancers were subject to sales tax under Tax Law § 1105 (f) (1) as admission charges to a place of amusement and under Tax Law § 1105 (f) (3) as the charges of a roof garden, cabaret, or other similar place. Petitioners' argument against the taxability of these transactions wrongly focuses on the treatment of the

customer's payment after the transaction, i.e., whether the payments are retained by the employee or whether the payments are included in the employer's gross receipts. Sales tax, however, is a transaction tax with liability occurring at the time of the transaction (20 NYCRR 525.2 [a] [2]). Persons required to collect sales tax must do so at the time of purchase (Tax Law § 1132 [a] [1]). Furthermore, the tax is payable, in the first instance, by the customer, and is in addition to the charge to which it applies (20 NYCRR 525.2 [a] [4]; Tax Law § 1132 [a] [1]). As noted, we have held that sales tax is collectable on similar scrip sales at the time the customer purchases the scrip (***Matter of Executive Club, LLC confirmed sub nom Gans v New York State Tax Appeals Trib.***). Petitioners here simply failed to charge and collect sales tax from their customers at the time of the transactions. Accordingly, whether customer payments to the dancers may be considered gratuities for labor law purposes or whether petitioners included revenue from the scrip transactions in their gross receipts does not determine the taxability of those transactions.[21]

Petitioners' argument on this point also fails on the facts, as the record shows that the dancers did not retain the full amount paid to them for dances. First, they lost 10% on redemption. Additionally, the "rent" entries in the ledger books indicate, dancers occasionally used their redeemed scrip payments to directly pay petitioners the required fee of $150.00 per performance date. Further, it is reasonable to infer that the dancers generally paid such performance fees with amounts earned from performing.

Petitioners seek to distinguish the present matter from previous cases finding sales of scrip in adult entertainment clubs to be taxable where such scrip was used to pay charges taxable under Tax Law § 1105 (f). Petitioners note that the club operators in those cases derived

[21] As it is inconsequential here, we take no position as to whether the charges paid by customers to the dancers were gratuities for FSLA or Labor Law purposes.

revenue from scrip transactions through the scrip surcharge and the redemption fees either by selling the scrip directly or through a commonly controlled corporation (***see Matter of Gans v New York State Tax Appeals Trib.***; ***Matter of HDV Manhattan, LLC v Tax Appeals Trib. of the State of N.Y.***). In contrast, Metro, a third party, received the scrip surcharges and redemption fees in the present matter. Petitioners contend that they did not derive revenue from the scrip transactions and did not sell dances for profit, contrary to the Administrative Law Judge's findings.

The differences between the facts in the present matter and the facts in ***Gans*** or ***HDV*** do not affect petitioners' sales tax liability for the scrip transactions at issue. As discussed, the scrip transactions were taxable as amusement charges pursuant to Tax Law § 1105 (f) (1) and (3). Entities and individuals may be liable for the collection and remittance of sales tax on such transactions pursuant to Tax Law § 1133 (a) as "persons required to collect tax," which, as relevant here, means "recipients of amusement charges" (***see*** Tax Law § 1131 [1]). The dancers who solicited the scrip transactions were employees and therefore under petitioners' direction and control. Moreover, the dancers were an integral part of petitioners' business (***see*** finding of fact 10) and the scrip transactions were a significant part of the Clubs' operations, generating, by far, more revenue than the other areas of petitioners' operations (***see*** findings of fact 55, 56, 59 and 60). The transactions were facilitated by other employees of the Clubs, who were also under petitioners' direction and control (***see*** finding of fact 11). Petitioners' customers thus paid petitioners' employees charges for entertainment or amusement provided by petitioners' employees at petitioners' places of business. Accordingly, petitioners were recipients of those entertainment or amusement charges for purposes of Tax Law § 1131 (1) and therefore liable for the tax on those transactions under Tax Law § 1133 (a). That petitioners entered into voluntary agreements with Metro to handle credit card purchases of scrip does not change petitioners'

status as recipients of amusement charges (***see Matter of Henrie***, Tax Appeals Tribunal, November 22, 2017; ***Matter of Kieran***, Tax Appeals Tribunal, November 13, 2014).

We note, too, that petitioners' claims that they did not derive revenue from the scrip transactions and that they did not sell dances for profit are misleading because petitioners clearly derived economic benefit from the sale of dances at their clubs. Specifically, petitioners' agreements with Metro gave petitioners the benefit of Metro's assumption of risks associated with the credit card transactions and the provision of dancer referrals in exchange for the scrip surcharge and the redemption fees. We presume that this was a fair exchange. In addition, the use of the scrip revenue to compensate dancers benefitted petitioners by funding a significant cost of doing business. Petitioners further benefitted from scrip sales of private dances through room rentals, since all private dances required a room rental. Furthermore, given the centrality of the dancers to petitioners' operations, the presence of the dancers, including the sale of lap and private dances via scrip, likely drove petitioners' door admissions and bar sales.

We reject petitioner's contention that their room rentals were not subject to sales tax. Private dances were provided in private rooms (***see*** findings of fact 5 and 6). Therefore, every purchase of a private dance required a room rental. Contrary to petitioners' contention, then, room rentals were associated with another taxable charge. Specifically, when used for private dances, the rooms were places of amusement under Tax Law § 1101 (d) (10) and the room rental, whether paid in cash or scrip, was an admission charge pursuant to Tax Law § 1101 (d) (2). We have previously determined that amounts paid to use a private room for a private dance in an adult entertainment club are subject to sales tax pursuant to Tax Law § 1105 (f) (1) and (3) (***Matter of HDV Manhattan, LLC v Tax Appeals Trib. of the State of N.Y.***; ***Matter of The Executive Club LLC***).

Petitioners assert that customers were not required to purchase a private dance to rent a

room. The Administrative Law Judge, however, rejected Mr. Capeci's testimony on this point as "incredible," a finding to which we defer (***Matter of Majestic Deli Grocery, Inc.***). Petitioners have provided no other evidence of room rentals without an associated private dance. Under such circumstances, it is reasonable to conclude that payment of both the room fee and the dancer's fee were required to enter one of the private rooms for a private dance and thus both fees constituted an admission charge (***Matter of HDV Manhattan, LLC v Tax Appeals Trib. of the State of N.Y.***, 156 AD3d at 966; Tax Law § 1132 [c]).

The authorities cited by petitioners on this point offer little support to their position. Specifically, rental on practice rooms rented by a business that made sales and repairs of musical instruments and provided music lessons was deemed nontaxable on audit in ***Matter of Wilmarth*** (Tax Appeals Tribunal, June 4, 2015) and therefore was not an issue in our decision. Additionally, the lease of facilities by a social club (as defined in 20 NYCRR 527.11 [b] [6]) was deemed nontaxable in a nonprecedential advisory opinion (***see*** TSB-A-17(5)S; ***see also*** 20 NYCRR 2375.5).

As we have concluded that petitioners' scrip sales and private room rentals were taxable under Tax Law § 1105 (f) (1) and (3), it is not necessary to address whether those transactions are alternatively taxable under Tax Law § 1105 (d).

Other than their contention that room rentals were not taxable, petitioners make no objection to the Division's audit methodology or its assertion of tax liability with respect to petitioners' bar sales, door admissions, coat check and room rentals. Accordingly, other than room rentals, discussed above, we do not address the Administrative Law Judge's findings regarding this portion of the assessments.

With respect to the Division's audit methodology pertaining to the scrip transactions, although petitioners contend that the Division improperly used Metro's bank deposits to

determine liability for the scrip transactions, they do not contend that such information was inaccurate. The use of third-party information to determine sales tax liability is well established as an acceptable audit method (***see e.g.***, ***Matter of Roebling Liqs. v Commissioner of Taxation & Fin.***, 284 AD2d 669 [2001], ***lv dismissed*** 97 NY2d 637 [2001], ***cert denied*** 537 US 816 [2002]; ***Matter of Lima***, Tax Appeals Tribunal, April 19, 2007). As the bank deposit information used by the Division accurately reflected credit card purchases of scrip at the Clubs, the Division's use of such information was reasonable (***Matter of Ristorante Puglia v Chu***, 102 AD2d 348, 350 [3d Dept 1984] [Division's audit method must be reasonably calculated to reflect tax due]). Petitioners' complaints that the Administrative Law Judge improperly determined that petitioners and Metro commingled bank accounts and that the determination improperly refers to the scrip transactions as "revenue streams" for petitioners are irrelevant to this conclusion.

Petitioners also contend that the audit of the scrip transactions was flawed because the Division failed to review the scrip ledgers during the audit. According to petitioners, the ledgers show that the dancers retained the scrip payments (less the redemption fee). As we have determined that the taxability of the scrip transactions does not turn on this factor, this objection to the audit methodology is properly dismissed.

We reject petitioners' equitable estoppel argument. "[T]he doctrine of estoppel does not apply in tax cases unless 'unusual circumstances support a finding of manifest injustice'" (***Matter of Ryan v Tax Appeals Trib. of the State of N.Y.***, 133 AD3d 929, 930 [3d Dept 2015] [internal quotation marks and citations omitted]). It is well-established that "previous assessments and audits are non-binding upon future years" (***Matter of Winners Garage, Inc.***, Tax Appeals Tribunal, April 16, 2014, ***confirmed sub nom Matter of Wolkowicki v New York State Tax Appeals Trib.***, 136 AD3d 1223 [3d Dept 2016]). This follows from the general

proposition that an administrative agency may correct its erroneous interpretations of the law (***Matter of Liberty Coaches v State Tax Commn.***, 79 AD2d 775, 776 [3d Dept 1980]). Accordingly, reliance on the result of a prior audit does not rise to the level of manifest injustice (***Matter of Washington Sq. Hotel LLC v Tax Appeals Trib. of the State of N.Y.***, 155 AD3d 1477, 1479 [3d Dept 2017], ***lv denied*** 31 NY3d 909 [2018]). It is also well-established that "'erroneous advice given by an employee of a governmental agency is not considered to rise to the level of an unusual circumstance' warranting invocation of the doctrine of estoppel" (***Matter of Winners Garage Inc. v Tax Appeals Trib. of the State of N.Y.***, 89 AD3d 1166, 1169 [3d Dept 2011], ***lv denied*** 18 NY3d 807 [2012] [internal quotation marks and citation omitted]). It follows, therefore, that statements made by Division auditors during the course of previous audits are insufficient to estop the Division in the present matter.[22]

As to petitioners' complaint of a lack of notice on the potential taxability of their scrip transactions, we observe that ***Matter of Marchello*** found scrip transactions in an adult entertainment club to be subject to sales tax. That decision was issued on April 14, 2011, about one year into the four-year audit period at issue and well before the commencement of the subject audits (***see*** finding of fact 24).

Additionally, petitioners have failed to establish their contention that the Division improperly adopted a policy that all scrip transactions in adult entertainment clubs are taxable in violation of the State Administrative Procedure Act. We agree with the Administrative Law Judge's finding that the record indicates that the Division did not have such a policy and made its determinations with respect to such scrip transactions on a case-by-case basis.

[22] The record contains little evidence of statements made in connection with any prior audits that would support petitioners' claim of a previous Division position that scrip transactions were not taxable. In support of their argument, petitioners refer to a letter dated December 24, 2008 from the Division to the representative of another adult entertainment club owned by Mr. Capeci referring to that other club's unique business model. However, Mr. Capeci's testimony describing that business model differs from petitioners' businesses as described

Petitioners' constitutional arguments are as-applied claims, which we may consider (***Matter of Eisenstein***, Tax Appeals Tribunal, March 27, 2003). Petitioners contend that the Division's audit was so deficient as to violate their due process rights. As discussed, the Division's audit method was reasonable. Hence, this contention is rejected. Petitioners also contend that the assessment of tax on the scrip transactions violated their due process rights by making it impossible for them to comply with both the labor laws and the Tax Law. According to petitioners, such an impossibility arises because the same monies that are considered gratuities belonging to the dancers for labor law purposes are also taxable charges under the Tax Law. Even assuming that amounts paid to the dancers are gratuities for labor law purposes, it is not, and was not, impossible for petitioners to comply with the Tax Law under the circumstances as described herein. As noted previously, sales tax is collectible from the customer at the time of the transaction and such tax is in addition to the amusement charge to which it applies (20 NYCRR 525.2 [a] [4]; Tax Law § 1132 [a] [1]). As also noted previously, petitioners simply failed to charge and collect sales tax from their customers at the time of the transactions. Petitioners also claim that the assessment deprives them of their constitutional property rights because they did not retain the monies derived from the scrip transactions. Petitioners were charged with collecting sales tax as trustees for and on account of New York State (Tax Law § 1132 [a] [1]; ***see also*** 20 NYCRR 525.2 [a] [4]). Petitioners have no other property rights in the taxes they are charged to collect.

The Division assessed penalties against petitioners pursuant to Tax Law § 1145 (a) (1) (i), and (i). Abatement of such penalties requires a showing of reasonable cause. Petitioners have failed to offer an argument asserting reasonable cause for their failure to properly collect and remit sales tax during the period at issue and for their failure to produce books and records

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herein.

for the audit period. Penalties are therefore sustained.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of 44th Enterprises Corporation and MLB Enterprises Corporation is denied;

2. The determination of the Administrative Law Judge, dated February 18, 2021, is affirmed;

3. The petitions of 44th Enterprises Corporation and MLB Enterprises Corporation are denied;

4. The four notices of determination, each dated November 30, 2016 (***see*** findings of facts 58 and 62), are sustained; and

5. The order of the Administrative Law Judge, dated August 5, 2021, is affirmed.

DATED: Albany, New York
May 26, 2022

/s/ Anthony Giardina
Anthony Giardina
President

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner

/s/ Cynthia M. Monaco
Cynthia M. Monaco
Commissioner