

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
THE EXECUTIVE CLUB, LLC	:	DETERMINATION
for Revision of a Determination or for Refund of Sales	:	DTA NO. 825850
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period December 1, 2007 through May 31, 2010.	:	

Petitioner, The Executive Club, LLC, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 2007 through May 31, 2010.

A hearing was commenced before Arthur S. Bray, Administrative Law Judge, in New York, New York, on April 28, 2015 at 10:30 A.M. and continued to conclusion on June 11, 2015, at 10:15 A.M., with all briefs to be submitted by October 5, 2015, which date began the six-month period for the issuance of this determination. Petitioner appeared by Mayer Brown, LLP (Alvan L. Bobrow, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUE

Whether the Division of Taxation correctly determined that the receipts from the sale of Executive Club dollars were subject to sales and use tax as admission charges.

FINDINGS OF FACT

1. Petitioner, Executive Club LLC, operates a gentleman's club called the Penthouse Executive Club (the Club). The Club is located at 603 West 45th Street, New York. It generated revenues from admissions, bar sales, food sales and performances of the entertainers.

2. Entertainers are licensees of the Club who are required to pay a house fee to receive a license to perform services on the Club's premises. The license permits the entertainers to use the Club's facilities to earn income. The house fee varies during the week, with busier nights being more expensive.

3. Depending upon the day, the Club's customers pay an admission charge of \$20.00 to \$30.00 dollars to enter the Club. The admission charge may be paid with a credit card or cash. It may not be paid with executive dollars. Upon remittance of the admission charge, guests may go anywhere within the Club except for the private rooms. The Club collects and remits sales tax on the admission charge.

4. Entertainers earn income by performing dances for and spending time with the Club's guests. The transactions are between the entertainers and the guests and are not recorded on petitioner's records. The Club's customers pay the entertainers by cash or executive dollars.

5. The Club encourages guests to purchase scrip called "executive dollars" to pay entertainers. The benefit of executive dollars arises from the fact that there is a surcharge, which produces income for the club. It also gives the entertainers the ability to make much more money than if the customers came in with only cash. When customers have the ability to purchase executive dollars with a credit card, they have the opportunity to spend more money on the entertainers and on the club.

6. In appearance, executive dollars are similar to play money insofar as they are printed in color with a picture of an entertainer on the front. The executive dollars state, among other things, "THIS NOTE IS LEGAL TENDER FOR TABLE DANCES AND TIPPING ONLY." They have an expiration date, and may not be redeemed or used once the expiration date has passed.

7. The executive dollars list items that are offered by the Executive Club such as private dining rooms, private theme rooms, executive penthouse suites, champagne lounges, table dancing and cocktails. It is not a list of what the executive dollars may be used for.

8. A customer may purchase executive dollars at a booth in the Club. In some cases, a host or manager may obtain executive dollars for the customer.¹ The Club adds a 20 percent surcharge when the executive dollars are purchased. As a result, it costs \$1,200.00 to purchase \$1,000.00 of executive dollars. For verification, a driver's license must ordinarily be presented along with a credit card to purchase executive dollars.

9. Once purchased, guests determine how to use executive dollars. For example, a guest may choose to spend all of the executive dollars on one entertainer or may choose to spend the executive dollars on dances from a number of different entertainers. However, consistent with what is printed on the face of the scrip, executive dollars may only be used to pay entertainers or for tipping hosts. For example, they could be used to pay for a dance or spending time with an entertainer anywhere in the club. They may not be used to purchase food or beverage at the club and are not redeemable at outside retailers.

¹ The host worked for both Rooms With a View (RWV) and petitioner. RWV was a separate corporation that maintained its own books. It was the subject of a separate sales tax audit. The business conducted by RWV pertained to admission to the private rooms and administration of the rooms. The charges for gaining admission to a private room were reported on the separate sales tax returns of RWV. RWV was a tenant of the Executive Club and paid for utilities and maintenance services.

10. Guests are not required to purchase executive dollars in order to enter the club. For example, a guest, without purchasing executive dollars, is permitted to pay the admission charge, enter the club and purchase food and a beverage. They may also purchase a dance for cash.

11. After paying the house fee pursuant to the license agreement, entertainers redeem executive dollars that they receive from guests. The club charges a 13 percent fee for redeeming executive dollars. Accordingly, entertainers receive \$87.00 from the Club for every \$100.00 of executive dollars redeemed. Entertainers are permitted to redeem the executive dollars at the Club's office or at night with an individual known as the night auditor. An entertainer may also use the executive dollars to pay the house fee, pay the hair or makeup person or tip the DJ. At the end of the year, the Club gives entertainers a form 1099 for the amounts received.

12. Petitioner does not report the revenue received from executive dollars on its income tax return because it does not consider these funds to be income. Rather, petitioner regards it as money earned by the entertainers.

13. Private rooms at the club could be rented for brief periods of time from Rooms With a View, LLC.

14. An individual, known as a room administrator, advised interested guests which rooms were available and what the charge was for the different rooms. Guests wishing to occupy a particular room would pay for the room by offering the room administrator cash or a credit card. The room administrator would not accept executive dollars to pay for the occupancy of a room.

15. Receipts for the rooms were reflected on the books and records of the Executive Club and on the records of Rooms With a View.

16. On August 23, 2010, the Division mailed a letter to petitioner scheduling a field audit for the period December 1, 2007 through May 31, 2010. The letter advised petitioner that it must

be prepared to “show **all** of your sales and use tax books and records to the auditor.” A schedule of books and records to be produced was attached to the letter. There was no response to this letter. On September 7, 2010, the Division mailed a second letter to petitioner which scheduled the audit at petitioner’s place of business on September 29, 2010. The parties met as scheduled and the Division explained the nature of the audit and what records were needed. Petitioner did not produce any records on this date. Since no records were made available, the Division asked petitioner’s representative to sign a waiver and he agreed.

17. On October 13, 2010, the Division received a Consent Extending Period of Limitations for Assessment of Sales and Use Taxes Under Articles 28 and 29 of the Tax Law until on or before March 20, 2012. On December 2, 2011, the Division received a second consent extending the period for the assessment of sales and use taxes to any time on or before March 20, 2013.

18. Field audit appointments were held on November 23, 2010 and February 17, 2011 wherein different portions of petitioner’s books and records were made available on each occasion. A Test Period Audit Method Election form was executed for the audit of sales and recurring expense purchases. Following the audit, the Division concluded that the correct amount of sales tax was paid on the sales of food, beverage and coat check services. Additionally, the Division determined that sales tax was collected and remitted on admission charges that customers paid to enter the Club. However, utilizing the test period audit method, the Division also determined that sales tax was due on drinks that were given away for free (commonly known as complementary liquor). This portion of the audit resulted in assessing additional taxable sales of \$311,468.00. The Division also conducted a detailed review of the sale of executive dollars and determined that these sales were taxable as admission charges to a

place of amusement. This conclusion resulted in finding additional taxable sales of \$28,425,440.00.² Lastly, the Division examined expense purchases and found that there were additional taxable expense purchases of \$89,785.43.

19. At the hearing, petitioner chose not to challenge those portions of the audit that concerned complementary liquor or expenses.

20. On the basis of the foregoing audit, the Division issued a Statement of Proposed Audit Change for Sales and Use Tax stating that tax was due in the amount of \$33,604.98 plus interest for a balance due of \$41,837.40. The Division also issued a Statement of Proposed Audit Change for Sales and Use Tax stating that tax was due in the amount of \$2,425,261.57 plus interest for a balance due of \$3,046,324.32.

21. On July 6, 2012, the Division issued notices of determination that assessed sales and use tax for the period December 1, 2007 through May 31, 2010 as follows:

Assessment Number	Period Ending	Tax	Interest	Balance
L-038251889-7	May 31, 2010	\$33,604.98	\$9,215.12	\$42,820.10
L-038264666-8	May 31, 2010	\$2,425,261.57	\$692,616.02	\$3,117,877.59

22. In accordance with State Administrative Procedure Act § 307(1), petitioner's proposed findings of fact have been generally accepted and substantially incorporated herein. However, a portion of proposed finding of fact 1 is not supported by the record, portions of proposed findings 4, 5 and 13 were omitted because they lacked a reference to the transcript or an exhibit and the last sentence of proposed finding of fact 8 was omitted because it was duplicative of another finding of fact.

² The amount of tax due was determined by adding up the total amount of executive dollars listed on a spreadsheet for the entire audit period and imposing sales tax on that amount.

SUMMARY OF THE PARTIES' POSITIONS

23. The only issue litigated at the hearing was whether the Division properly imposed sales tax on petitioner's sales of executive dollars. As noted, the Division contends that such sales were subject to tax as an admission charge. Petitioner, on the other hand, maintains that executive dollars could only be used for spending time with the entertainers or tipping and not for admission to a private room and therefore not taxable as an admission fee.

24. The testimony offered by the parties reflects the conflicting version of the facts. A resolution of this conflict requires a review of the testimony. At the hearing, auditor Larry Mungal testified that the Division determined that the sale of executive dollars was subject to tax because they were used as an admission charge to a place of amusement. The auditor's supervisor, Roy Watson, participated in the audit and similarly concluded that the executive dollars were taxable as an admission charge. When he was advised of Mr. Watson's conclusion, petitioner's representative replied that approximately one-third of the sales of executive dollars would not be subject to tax because it was used for nontaxable purposes. Lastly, the Division offered the testimony of Alicia Carpio, an auditor who conducted the audit of the closely related corporation RWV. On the basis of her conversations with the individual who functioned as petitioner's chief financial officer, Ms. Carpio was under the impression that executive dollars could be used for any purpose inside the club. Ms. Carpio was at the Executive Club only in the morning, when it was not open to the public.

25. Petitioner presented the testimony of Mr. Howard Rosenbluth. Mr. Rosenbluth provided accounting services, as an independent contractor, for petitioner and functioned as the chief financial officer. He also provided accounting services for RWV. According to Mr. Rosenbluth, executive dollars could only be used for tipping and paying an entertainer. In

particular he stressed that they could not be used for admission to a room or to purchase food or drink.

26. Petitioner also presented the testimony of Mark Yakow who served as the chief operating officer of the Executive Club. He explained that the function of the scrip was for customers to use for spending time with the entertainers. He further explained that a customer could only use the scrip to sit with an entertainer at dinner, purchase a dance or for tipping.

27. In its brief, petitioner argues: that the Division lacks a legal basis for imposing sales tax on the receipts of executive dollars since they are not tangible personal property or an enumerated service, that executive dollars are not an admission charge, that *Matter of 677 New Loudon Corp.*, (Tax Appeals Tribunal, April 14, 2010, *confirmed* 85 AD3d 1341 [2011], *affd* 19 NY3d 1058 [2012], *reargument denied* 20 NY3d 1024 [2013], *cert denied* 134 S Ct 422 [2013]) and *Matter of Marchello* (Tax Appeals Tribunal, April 14, 2011) are factually distinct and, therefore, not controlling, and that if executive dollars could be used to purchase admission to private rooms the Division would wrongly be attempting to tax the same transaction twice.

28. In response, the Division argues that all of the issues raised have been settled by the Tax Appeals Tribunal, that petitioner was a vendor responsible for sales and use taxes and is responsible for any taxes due on admission receipts, that petitioner's admission charges are taxable pursuant to Tax Law § 1105(d); (f)(1), (3) and that RWV and the Executive Club recorded separate admission charges on their books so there is no issue of double taxation.

29. In its reply brief, petitioner submits that the precedents cited by the Division do not address the facts presented here, that it is undisputed that petitioner is a vendor, that there are only two admission charges, admission to the club and admission to the room, and that there is no additional admission charge to tax, that executive dollars cannot be used to gain admission to

private rooms, that executive dollars are not charges for a roof garden, cabaret or other similar place of entertainment under Tax Law § 1105(f)(3) and that executive dollars are not cover charges under Tax Law § 1105(d).

CONCLUSIONS OF LAW

A. Before proceeding to a resolution of the legal arguments, a highly controverted fact should be addressed. Namely, whether executive dollars may be used to purchase admission to the private rooms. In my opinion, the weight of the evidence supports petitioner's position that executive dollars were not used to purchase admission to the private rooms. Although I do not question the Division's good faith belief that executive dollars were used for this purpose, the testimony must be critically examined.

As noted, Mr. Watson, the auditor assigned to this matter, concluded that executive dollars were taxable as admission charges. Similarly, Mr. Mungal, the auditor's supervisor, who assisted on the audit, stated that executive dollars could be used for admission to "the rooms and the girls." However, the record does not show what these individuals were relying upon to reach this conclusion. Under the circumstances, it is difficult to accord these opinions substantial weight. Alicia Caprio conducted an audit of RVW and stated that she never visited the club during working hours. Ms. Caprio explained that it was her belief that executive dollars could be used to purchase admission to a private room. However, her understanding was based upon her conversation with Mr. Rosenbluth. Since Mr. Rosenbluth clearly testified that executive dollars could not be used to gain admission to private rooms, this testimony must also be discounted.

In contrast, petitioner's witnesses, who were employed as, respectively, petitioner's accountant and as its chief operating officer, clearly and consistently stated that executive dollars could only be used for tipping and for paying entertainers. This testimony was consistent with

the statement on the face of the executive dollars that the executive dollars were “legal tender for table dances and tipping only.” It is also consistent with the finding that RWV was created for the purpose of managing private rooms. Under the circumstances, I conclude that executive dollars could not be used for admission to private rooms.

B. It is petitioner’s position that it paid tax on the charge for admission to the club and that there was no other taxable admission charge. In response, the Division has correctly responded that petitioner’s argument fails to consider the holding in *Matter of Marchello* (Tax Appeals Tribunal April 14, 2011).

C. In *Marchello* one of the issues presented was whether the taxpayer was responsible for the taxes due from the VIP Club of NY (VIP Club or Club). The VIP Club was a firm that, along with two other corporations, managed the operations of an adult entertainment facility. During the audit period, the Club derived most of its revenue from the sale of “dance dollars.” This was scrip that the firm’s customers could use to purchase exotic dances or tip dancers or wait staff. The charges for dance dollars were invoiced and received by the Club, which did not collect sales tax on its sales of dance dollars. The Club did not charge an admission fee when a customer wanted to purchase a dance in a private room. However, it did charge customers for the dance dollars that were spent paying the dancer in the private room. Sales tax was not charged on the private room dances. In its decision, the Tribunal considered several issues, one of which was the taxability of the sale of the scrip. As noted by the Division, the following analysis by the Tribunal is instructive and determinative of the resolution of this matter.

“We further hold that the sale of dance dollars by Club VIP are properly taxable as amusement charges (*see 677 New Loudon Corp.*, Tax Appeals Tribunal, April 14, 2010). The record establishes that the VIP Club is a place of amusement pursuant to Tax Law § 1101(d)(10) (*see Matter of Antique World*, Tax Appeals Tribunal, February 22, 1996). The subject notice assesses taxes on

the sale of dance dollars by Club VIP, which are used to purchase exotic dances from exotic dancers at the VIP Club.

These dance dollars constitute admissions fees within the meaning of Tax Law § 1105(f)(1). . . .

In *Matter of 677 New Loudon Corp.*, (*supra*), we similarly held that the taxpayer's charges for both public and private dances were subject to sales tax under Tax Law § § 1105(d), 1105(f)(1) and (3).

Herein, the VIP Club patrons used dance dollars to purchase exotic dances both "in the open" and in private rooms, with the receipts collected by Club VIP. These transactions are identical to those presented in *Matter of 677 New Loudon Corp.*, (*supra*) and *Matter of 1605 Book Ctr.*, (*supra*). The use of a shell corporation to manage and collect the exotic dance receipts does not affect the basis for the imposition of tax. As such, the receipts of Club VIP from the purchase of exotic dances are properly subject to sales tax on the same grounds (i.e. Tax Law §§ 1105[d], [f][1], and [f][3])."

D. The similarity between the facts presented herein and those presented in *Marchello* is readily evident. Petitioner argues that *Marchello* is not controlling because the scrip in this matter may not be used to purchase admission to a private room. This argument is unpersuasive. Although petitioner is correct that, unlike the matter at issue, the scrip in *Marchello* could be used to acquire admission to a private room, it is equally clear that the scrip could also be used to obtain a dance in a public area. The Tribunal found that the scrip was subject to sales tax in each instance. It follows that the distinction relied upon by petitioner is of no consequence and petitioner's attempt to distinguish *Marchello* is rejected.

E. Petitioner's contention that the imposition of tax on the sale of the executive dollars constitutes double taxation is rejected. Petitioner's own evidence shows that admission to the private rooms could only be accomplished by the payment of cash or a credit card. However, the admission charge to gain access to an exotic dance was paid for by scrip. Since the receipts for the two activities were separate, there is no incidence of double taxation.

F. In view of the foregoing conclusion, the remaining arguments are moot and will not be addressed.

G. The petition of The Executive Club, LLC, is denied, and the notices of deficiency dated July 6, 2012 are sustained, together with such interest as may be lawfully due.

DATED: Albany, New York
January 28, 2016

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE