STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions of **WEST 2OTH STREET ENTERPRISES CORPORATION PACIFIC CLUB HOLDINGS, INC. SUSHI FUN DINING & CATERING, INC. AND DOMINICA O'NEILL** for Revision of Determinations or for Refunds of New York State Sales and Use Taxes Under Articles 28 and 29 of the Tax Law for the period December 1, 2007 through November 30, 2013.	DETERMINATION DTA NOS. 828472, 828473, 828474 AND 828475

Petitioners, West 20th Street Enterprises Corporation, Pacific Club Holdings, Inc., Sushi Fun Dining & Catering, Inc., and Dominica O'Neill, filed petitions for revision of determinations or for refunds of New York State sales and use taxes under articles 28 and 29 of the Tax Law for the period December 1, 2007 through November 30, 2013.

A consolidated hearing was held before Kevin R. Law, Administrative Law Judge, in New York, New York, on March 5, 2020, with all briefs to be submitted by November 6, 2020, which date commenced the six-month period for issuance of this determination. Petitioners appeared by Bartons, LLP (Alvan L. Bobrow, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Osborne K Jack, Esq., of counsel).

ISSUES

I. Whether the sale of script by a corporation at an adult entertainment establishment is a taxable admission charge to a place of amusement for sales tax purposes.

II. Whether West 20th Street Enterprises Corporation and Sushi Fun Dining and Catering, Inc., are liable for sales tax due on the sale of scrip as co-vendors with Pacific Club Holdings.

III. Whether the Division should be estopped from asserting sales tax on the sale of scrip at the VIP Club.

IV. Whether the assertion of tax on the sale of scrip at the VIP Club violates the United States and New York State constitutions.

V. Whether penalties should be abated.

FINDINGS OF FACT

1. On August 5, 2013, the Division of Taxation (Division) commenced an audit of petitioner West 20th Street Enterprises Corporation (West 20th). West 20th operates an adult entertainment establishment called the VIP Club, at 20 West 20th Street, New York, New York, (the Club). Selim Zherka and Maurice Kavanaugh owned West 20th.

2. On October 24, 2013, the Division's auditor and section head met with West 20th's representatives, accountants Robert Sands and Nicolas Puglisi, at its business location. At this meeting West 20th's representatives explained that two other entities operated the Club with petitioner; to wit: petitioners Sushi Fun Dining & Catering, Inc. (Sushi Fun) and Pacific Club Holdings, Inc. (Pacific Club). It was explained that West 20th's primary function and source of revenue was from admission charges and coat check charges; Sushi Fun operated the restaurant (food and liquor sales) and Pacific Club's function was dispensing "funny money" (scrip or VIP currency) at the Club.

3. Based on the ongoing audit of West 20th, the Division started field audits of Sushi Fun and Pacific Club. These entities were also represented by Messrs. Sands and Puglisi.

4. Although Sushi Fun operated the restaurant operations in the Club, the liquor license for the Club is held by West 20th. Sushi Fun is also owned Messrs. Zherka and Kavanaugh.

5. Pacific Club is owned by petitioner Dominica O'Neill. Prior to 2006, Pacific Club was owned by Messrs. Zherka and Kavanaugh. The record does not reveal how or exactly when Ms. O'Neill came to own Pacific Club and/or how and why Mssrs. Zherka and Kavanaugh transferred ownership of Pacific Club to her.[1]

6. Beginning in 2012, the Club maintained a point of sale system (POS) upon which sales from all three entities were recorded. Petitioners' representatives stated that the POS system was not reliable and, therefore was not used to prepare West 20th's or Sushi Fun's sales tax returns. Pacific Club was not a registered sales tax vendor, nor did it file sales tax returns. According to Pacific Club's representatives, Pacific Club did not engage in any taxable transactions for sales tax purposes.

7. As noted, Pacific Club's function was to dispense scrip in the Club. A concession agreement between Pacific Club and West 20th, dated October 13, 2005, provided that in exchange for $25,000.00 a month, Pacific Club had the exclusive right to operate a scrip desk at the Club, the purpose of which was to "facilitate transactions for patrons desiring to hire entertainers for First Amendment of the United States Constitution of expressive activities…." The terms of the agreement provide that Pacific Club could not impose a surcharge in excess of 20% to patrons to facilitate scrip transactions. The concession agreement is signed by Ms. O'Neill, but it does not indicate what her title with Pacific Club was at that time.

[1] New York S Corporation Shareholders' Information Schedules filed by Pacific Club for 2005 and 2006 list Selim Zherka and Maurice Kavanagh as the owners of Pacific Club. A separate schedule for 2006 indicates that Ms. O'Neill was the sole shareholder.

8. An example of the scrip used at the Club was introduced into the hearing record by petitioners. The scrip is in a denomination of "20" and is entitled "The New VIP Club New York" and lists the Club's address. It states that "[t]his Bill is Legal Tender for Table Dances and Tipping Only." There is an expiration date on bottom of the scrip. On the right side of the scrip in fine print it states as follows:

> "WE ARE ACCOMODATING YOU IN PAYING OUR TENANTS WHO ARE PERFORMERS PROVIDING A SERVICE TO YOU, UNRELATED TO US. OUR SERVICE IS PROVIDING YOU WITH A CURRENCY SO YOU CAN PAY THE PERFORMERS. THIS CURRENCY IS NOT VALID FOR ADMISSION, FOOD OR BEVERAGES OR PRIVATE LOUNGE RENTALS. THIS CURRENCY IS USED FOR TIPPING SELF EMPLOYED ENTERTAINERS WHO ARE ENGAGING IN A FIRST AMENDMENT EXPRESSIVE ACTIVITY."

9. On April 29, 2016, the Division's auditors went to the Club to observe its operations. To gain admission to the Club, a patron was required to pay an admission charge of $20.00 after 9:00 p.m. The admission charge was waived if the patron had a coupon or a "VIP Platinum card." Admission to the Club allowed a patron to view live performances on the Club's stage. It was observed that admission charges and coat check charges were collected and were being recorded in a POS system near the door.

10. The Club consists of two floors, with the restaurant operated by Sushi Fun occupying the second floor. There are five private rooms on the second floor and eleven semi-private rooms on the first floor for private dances. A patron seeking a private dance would arrange the dance with the Club's host and was charged $500.00 per hour for a private room plus $600.00 an hour for the dancer; a semi-private room incurred a charge of $400.00 for the room plus $500.00 per hour for the dancer. The room charges were collected by the Club and reported by Sushi Fun as lounge charges. A sign on the wall stated that sales tax was included in the room charges. The patron would pay the dancer for her charge using either cash or scrip. The Club's manager

told the auditors that a dancer was entitled to keep all dance fees and tips paid in cash but would be charged fee upon redemption of scrip. Patrons paid a 20% surcharge on the purchase of the scrip and, when the dancers redeemed the scrip, they paid an additional 10% processing fee. According to the audit log, the Club's manager also told the auditors that scrip could only be used to pay the dancers and could not be used to purchase food, drinks or be used for tipping.

11. Included in the hearing record are copies of the contracts for fourteen of the dancers and West 20th doing business as the Club. The contracts are denominated as a non-exclusive lease of entertainment facilities. Under the terms of the contracts, the dancer and Club disavowed an employment relationship. Pursuant to these lease agreements, West 20th leased its stage areas to the dancers "to market [their] entertainment." In return, the dancer would pay a fee to the Club. The Division's auditors were told by the Club's manager that the dancers paid $80.00 to $120.00 per night to entertain at the Club. This fee was recorded as rent revenue on the Club's POS system and reported by Sushi Fun. Under the terms of each contract, the dancer was required to perform eight stage shows per performance date and was required to schedule her performance dates through Pacific Club. Pursuant to the contract, the dancer was "entitled to keep all dance fees paid to her and all 'tip' (gratuities) given to her by patrons during her performance date, during any period during which she is considered a 'tenant' and not an 'employee.'" Of the fourteen contracts introduced into evidence, two provided that the "[dancer] agreed to charge the fair market rate as determined by the New York City Adult Entertainment Industry wide standards for dancing in private Champagne Rooms." In addition, five of the contracts contained a provision stating that the "[dancer] agreed to charge the fair market rate as determined by the New York City Adult Entertainment Industry wide standards for table dancing and in private champagne lounges . . ."

12. Included in the record are confidentiality agreements signed by various dancers wherein dancers agreed to keep certain information of the "the Company" confidential. "The Company" is defined in the confidentiality agreements as "[Pacific Club, Sushi Fun, West 20th], its members, managers, shareholders, beneficiaries, partners, agents, affiliated companies, principals, officers, directors, tenants, their successors and assigns doing business at 20 West 20th Street, New York, N.Y."

13. In addition to acting as the scrip dispenser, Pacific Club acted as the Club's booking agent. Contracts in the record between dancers and Pacific Club indicate that in return for being booked at the Club to dance, the dancer was required to pay a referral fee of 20% ". . . of the face value of all [scrip] obtained by patrons . . . and used to pay DANCER for her service of rendering private dances."

14. During the audits, petitioners provided POS records for 2012 and 2013. During the course of the audits, the Division obtained third party credit card information which was used to compare sales reported by each of the corporate petitioners to sales reported.

15. The audit of Sushi Fun resulted in no change, while the Division determined that West 20th owed additional sales tax of $16,000.00, which amount was agreed to and is not at issue herein.

16. The audit of Pacific Club led to the determination to assert sales tax on amounts paid for scrip. Using third-party credit card data for Pacific Club for 2011, 2012 and 2013, the Division calculated sales tax due for those years by multiplying the third-party credit card receipts for that period of $12,877,649.32 by the tax rate to determine sales tax due of $1,142,891.38.

To determine sale tax for 2007 through 2010, the Division first determined how much of total credit card sales were reported on its income tax filings. During the audit period, Pacific Club reported credit card commissions on its income tax returns, which represented processing fees charged to the Club's patrons and its dancers. For 2011 through 2013, the Division determined that reported commissions amounted to 24.69% of actual credit card receipts. Since Pacific Club did not provide any records for 2007 through 2010, the Division multiplied the reported commissions for each of those years on its income tax filings by 24.69% to determine receipts from sales of scrip of $13,747,078.77 and computed tax due of $1,176,049.07, for those years. Total tax asserted due for the period December 1, 2007 thru November 30, 2013 amounted to $2,318,940.40.

17. Michael Russell, a sales tax section head with the Division, testified at the hearing and explained the rationale for the assertion of tax in this matter. Mr. Russell supervised the auditor who had initiated the audit but is no longer employed by the Division. Mr. Russell accompanied the auditor on his field appointments and was involved in every aspect of the audits. Mr. Russell explained the Division determined that in addition to Pacific Club, West 20th and Sushi Fun were responsible for the taxes due on sales of scrip because the three entities operated as one business. Mr. Russell explained that the Division began with an audit of West 20th and during that audit, the Division learned that West 20th and Sushi Fun were involved in the operation of the Club. Mr. Russell stated that the Division audited all of the entities to understand the operation of the Club. Mr. Russell noted that during the audits, all three entities were represented by the same representatives and that the Club's records were provided in one POS report. He explained that the Division had to review the one POS system to determine what sales were attributable to which entity. Mr. Russell stated that "… when a customer walks in and

a person takes their coat, they think the VIP Club is taking their coat, and when they go get a drink at the bar, they think the VIP Club is selling them a drink. When they go get funny money, they think that VIP is giving them funny money, so we felt that it's one club, one establishment, separated into three entities for reporting purposes."

18. Consequently, on August 30, 2016, the Division issued notice of determination L-045423066 to Pacific Club assessing sales tax due of $2,318,940.40, plus penalties and interest.

19. On August 31, 2016, the Division issued notices of determination L-045427441, L-045427440 and L-045427439 to Ms. O'Neill, Sushi Fun and West 20th, respectively. Each of the notices asserts tax due of $2,318,940.40, plus penalties and interest, as persons responsible for the taxes due from Pacific Club. At the hearing in this matter, Ms. O'Neill conceded she is a responsible person of Pacific Club but did not concede that Pacific Club owes tax.

20. Mr. Zherka and petitioners' representative, Alvan Bobrow, testified for petitioners in this matter. Although Ms. O'Neill was present at the March 5, 2020 hearing in this matter, she was not called as a witness.

21. Mr. Zherka was steadfast in his testimony that scrip could only be used for tipping and that the Club did not charge patrons for private dances. Mr. Zherka explained that the use of scrip was for patrons' convenience. Mr. Zherka alleged the Club was different from its competitors in that it did not charge for dances; the patron was free to tip or to not tip the Club's dancers and that the dancers could dance for free if they chose. Mr. Zherka testified that the Club did not realize any benefit from the sale of scrip by Pacific Club or the use thereof by Club patrons. While Mr. Zherka acknowledged that the Club was run by West 20th and Sushi Fun, he was adamant that other than dispensing scrip, Pacific Club's activities were separate and distinct and Pacific Club had no part in operating the Club.

22. Petitioners presented a letter dated December 24, 2008 from Carla Adsit-Vassari, Director of the Division's sales tax audit bureau, addressed to petitioners' representative, Mr. Bobrow. The letter provides in pertinent part, as follows:

> "New York State Department of Taxation and Finance Director of Tax Audits, Nonie Manion, asked me to respond to your letter dated October 14, 2008, regarding West 20th Enterprises Corp. and Notices and Demand, L-027740782 and L-027759052, issued against the corporation and responsible person Anthony Capeci, respectively. Also at issue is refund claim #2007-05-0477 for the period June 1, 2002 through August 31, 2002.
>
> In your letter you refer to conversations you had with Joseph Carzo. According to Mr. Carzo, he spoke to you on August 16, 2007 and informed you that if appropriate books and records were provided to corroborate the 'unique' business model of West 20th and the records reflect the business scenario as discussed in theory, then refund #2007-05-0477 representing the tax paid on Notice and Demand L-027740782, for the quarter ended August 31, 2002, would be approved and submitted for payment, subject to the approval of the State Comptroller. Applicable books and records for the refund claim period, June 1, 2002, through August 31, 2002, are needed to support any adjustment. As of this date, you have not provided records to support your position that the dance revenue is not subject to sales tax. Accordingly, until complete books and records are supplied to substantiate the business model of West 20th Enterprises, the refund will not be approved."

23. Petitioners also introduced a letter dated January 7, 2011 addressed to Mr. Bobrow that notified him that after performing a sales tax audit of Pacific Club Services, Inc., for the period December 1, 1999 through November 30, 2004, the Division determined that no additional tax was due.

24. Petitioners submitted a Satisfaction of Judgment dated January 20, 2012 for a warrant in the amount of $4,297,664.23, dated March 13, 2007, filed by the Division against West 20th. In addition, petitioners submitted a stipulation for discontinuance of proceeding wherein Mr. Zherka and the Division settled a sales tax matter before the Division of Tax Appeals for no tax due for the quarter ended November 30, 2005. Petitioners, through the testimony of Mr. Zherka, explained that based upon the letters referred to above and the resulting

audit action indicated that the Division subsequently accepted that the sale or exchange of scrip by Pacific Club was not a taxable transaction.

25. Mr. Bobrow was sworn in and testified concerning the background and the meaning of the December 24, 2008 letter from Ms. Adsit-Vassari referred to in finding of fact 22. Mr. Bobrow explained that he represented West 20th for a prior audit period. Although Mr. Bobrow's testimony was vague, it is evident that West 20th had undergone a sales tax audit that involved the same issues present herein and did not file a formal appeal. Instead, Mr. Bobrow approached upper level management within the Division and explained the Club's business model. Specifically, Mr. Bobrow explained that different legal entities were responsible for different functions within the Club and that the sale of scrip was handled by a separate entity not involved with the restaurant operations or other operations of the Club. According to Mr. Bobrow, auditors from the Division confirmed that the Club operated in the way detailed to the Division's management team and refunds were eventually granted. Mr. Bobrow opined that since the letter did not state it was for settlement purposes only, it was tantamount to an informal ruling that the sale of scrip by a separate entity is not subject to sales tax. Mr. Bobrow was cross-examined by the Division's representative at length about a declaration he swore to in a Fair Labor Standards Act (FLSA) action brought by a former disc jockey of the Club against petitioners herein and others involved with the Club (the Romero Action).[2] In the declaration, Mr. Bobrow stated that petitioners herein had requested an informal ruling from the Division with respect to the sales tax consequences of certain transactions. Mr. Bobrow averred that the Division made certain written findings that the transactions were not subject to sales tax and, as

[2] On May 21, 2014 Sheldon Romero, a disc jockey who worked at the Club, filed a lawsuit against petitioners Sushi Fun, Pacific Club, West 20th, Selim Zherka as well as ABCZ Corp., ABCZ Mgmt Corp., and John Does #1-10 in the Southern District of New York: Romero v ABCZ Corp., et al., No. 14-cv3653 (AT).

part of its findings, stated that the Division concluded that the dancers were neither independent contractors nor employees. In the declaration, Mr. Bobrow stated that Division's ruling provided the Club a competitive advantage over competing gentlemen's clubs and further claimed that disclosing any of the information concerning the informal ruling to the FLSA plaintiffs would harm the Club. Mr. Bobrow confirmed that the December 24, 2008 letter was the "informal ruling" referred to in this declaration. Mr. Bobrow acknowledged that the letter did not mention employees or independent contractors. When asked to explain his basis for making the statement in his declaration, Mr. Bobrow stated that "[m]aybe I should have said did not care whether they were. I said concluded, concluded because I made the inference that it was not an issue." Mr. Bobrow also claimed to not know the purpose for the declaration.

26. Prior to Mr. Bobrow's testimony, Joseph Carzo, the Division's Director of Tax Audits, testified at the hearing. Mr. Carzo stated that the December 24, 2008 letter represented settlement discussions held between the Division and the specific taxpayers mentioned in the letter. Mr. Carzo testified that he had never communicated to petitioners' representative that charges to view adult entertainment is not subject to sales tax.

27. Consistent with the testimony of Mr. Zherka, petitioners submitted the affidavit of Ninive Galan sworn to February 20, 2020. Ms. Galan professed to be an entertainer at the Club on and off since 2010. Ms. Galan averred that scrip would only be used for voluntary tipping purposes stating specifically that "the tip amount by a customer has been totally voluntary and or negotiable by and between the dancer and the customer."

28. During the course of petitioners' opening statement at the hearing in this matter, petitioners' representative stated that a subpoena had been prepared and was on its way to the Division of Taxation's Office of Counsel in an attempt to discern why notices of determination

issued to Times Square Restaurant Group, Ltd., Times Square Restaurant #1,Inc., Three Amigos SJL, Restaurant, Inc., and Maurice Kavanaugh, were cancelled by the Office of Counsel subsequent to a hearing in the Division of Tax Appeals in those matters (the Times Square matters), and prior to a determination being issued. A hearing in the Times Square matters occurred on June 26, 2019. The issue in those matters is identical to that in the present matter, i.e., whether the sale of scrip constitutes an admission charge to a place of amusement subject to sales tax. The notices of determination issued to the petitioners in the Times Square matters were settled via stipulations for discontinuance of proceeding for $0.00. and were filed with the Division of Tax Appeals on October 28, 2019. Copies of those stipulations for discontinuance of proceeding were entered into the hearing record at the hearing in this matter. The corporate entities therein have the same owners as the corporate petitioners herein. Notably, the corporation that sold scrip in that matter, Times Square Restaurant Group, was owned by Mr. Kavanaugh; while Ms. O'Neill owned Times Square Restaurant No 1., the function of which was rental of private rooms and booking events such as bachelor parties at the Cheetah Club. Mr. Zherka owned Three Amigos SJL, Restaurant Inc., which ran the Cheetah Club including the food and drink operations in that club.[3]

29. Following Mr. Zherka's testimony at the March 5, 2020 hearing in this matter, petitioners opted not to present the testimony of petitioner Dominica O'Neill or Maurice Kavanaugh, although both were present. The administrative law judge asked Mr. Bobrow if he was sure he did not want to call either Ms. O'Neill or Mr. Kavanaugh, because petitioners would

[3] Official notice of the hearing transcript in the Times Square matters 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. Since a court may take judicial notice of its own records (***Matter of Ordway***, 196 NY 95 [1909]), the Division of Tax Appeals may take official notice of its record of proceedings (***see Bracken v. Axelrod***, 93 AD2d 913 [3rd Dept 1983]).

be given as much time as needed for petitioners to present their case. Mr. Bobrow responded that he was satisfied with Mr. Zherka's testimony and would not need to call either individual as a witness.

30. Following the conclusion of testimony, petitioners requested that the hearing record be left open for petitioners to submit: (i) three affidavits of current or former entertainers or employees of "the Club;" and (ii) two deposition transcripts from a Fair Labor Standards Act suit brought against Cheetah Club, a related club that Mr. Selim Zherka and Dominica O'Neill owned and/or were associated with. On April 1. 2020, petitioner's submitted: (i) the affidavit of Diana O'Neill; (ii) the affidavit of Doreen Elliott; (iii) the affidavit of Dominica O'Neill; (iv) receipts from the purchase of script; (v) a September 29, 2017 deposition transcript of Diana O'Neill; and (vi) tax returns of Pacific Club Holdings, Inc. By letter dated May 5, 2020, the undersigned administrative law judge, notified the parties that the affidavits of Diana O'Neill, Dominica O'Neill and Doreen Elliott and the deposition transcript of Diana O'Neill were marked and taken into evidence. Since petitioners did not request that the hearing record be left open for the admission of Pacific Club's tax returns or receipts for the purchase of scrip, these items were not made part of the record.

31. According to the affidavit of Diana O'Neill (Mrs. O'Neill), she worked as a "house mom" at the Club and at the Cheetah Club from 2010 to 2013. In her affidavit, Mrs. O'Neill avers that scrip was only used for tipping and that dancers could dance for free if they chose.

32. The deposition transcript taken from Mrs. O'Neill dated September 29, 2017, in a Fair Labor Standards Act lawsuit entitled ***Guzman et al. v Three Amigos SJL Inc., et al.***, 14 Civ 10120 (Guzman FLSA action), which involved alleged FLSA violations involving the Cheetah Club, was also submitted as support for her affidavit. Her testimony during the deposition was

consistent with her affidavit herein wherein she avers that the Club's entertainers worked for tips that were totally voluntary. As a house mom, she collected rents from the tenants (entertainers) and provided them goods and services such as deodorant, sewing services, etc. She testified that she was not hired by anyone at the Cheetah Club, nor was she an employee of the Cheetah Club and claimed she started working there after she visited that club. She testified that on the date of the deposition, September 29, 2017, she no longer worked at the Cheetah Club. When questioned about whether she worked as a house mom at the Club, she stated that she only filled in as a house mom there one night. It was also revealed that she is petitioner Dominica O'Neill's mother.

33. Consistent with Mrs. O'Neill's affidavit, the affidavit of Doreen Elliott submitted by petitioners, states that scrip could only be used for tipping. Like Mrs. O'Neill, Ms. Elliott identified herself as a house mom at the Club.

34. In Dominica O'Neill's affidavit, she avers that she has been the sole shareholder and president of petitioner Pacific Club. Ms. O'Neill states that Pacific Club replaced the previous company, Pacific Club Services Corp., as the currency exchange company at the Club. She further averred that Pacific Club was contacted by the owners of the Club to provide currency exchange services (scrip) within the Club and that Pacific Club had its own employees, payroll, and credit card machines. According to Ms. O'Neill, Pacific Club and the Club had no common employees, shareholders, or managers. Finally, Ms. O'Neill stated that scrip could only be used for tipping.

35. At the hearing, the Division introduced a copy of a complaint filed by former dancers of the Club against each of the petitioners herein, as well as Maurice Kavanaugh, Selim Zherka ABCZ Corp. and ABCZ II Management Co., in the United States District Court for the Southern

District of New York (Acevedo Complaint). The Acevedo complaint alleges that while plaintiffs worked as dancers at the Club between May 2009 and September 2013, the defendants, inter alia, failed to pay plaintiffs minimum wages, illegally withheld plaintiffs' tips, forced plaintiffs to share tips with others in the club and imposed illegal fines on plaintiffs. In response to the Acevedo complaint, the defendants therein filed an amended answer and affirmative defenses on April 6, 2017. In the amended answer and affirmative defenses, the defendants alleged that scrip was not used for gratuities, that the amounts paid for dances were mandatory performance fees, that through the complaint, the plaintiffs were seeking to reclassify mandatory performance fees as tips, and that the dancers retained any tips given to them by patrons.

36. On March 19, 2020, petitioners served a subpoena duces tecum on the Division seeking "any and all documents and communications concerning or related to the decision to cancel the notices of determination issued to [the Times Square matters' petitioners]." The subpoena was issued by petitioners' representative herein, Mr. Bobrow.

37. On March 30, 2020, the Division brought a motion, seeking an order modifying or quashing the subpoena. By order dated September 3, 2020, the Division's motion was denied. Although the motion was denied, it was noted that the hearing record was not left open for documents that petitioners had yet to subpoena. The findings of fact and conclusions of law of that order are incorporated herein by reference as if set forth herein in their entirety.

CONCLUSIONS OF LAW

A. Tax Law § 1105 (f) (1) imposes sales tax on admission charges in excess of 10 cents to or for the use of a place of amusement in New York. Tax Law § 1101 (d) (2) defines an admission charge as "the amount paid for admission, season ticket or subscription to any place of amusement, including any service charge or any charge for entertainment or amusement or for

the use of the facilities therefor." The term "place of amusement" is defined by Tax Law § 1101 (d) (10) as "[a]ny place where any facilities for entertainment, amusement, or sports are provided." Clearly, as the Club was a place of amusement, the question to be answered is whether the sale of said scrip qualifies as an admission charge. The answer to that question is dependent on whether the scrip was used to purchase dances or was strictly used for tipping. If the scrip was solely used for tipping, as is alleged by petitioners, then the sale of said scrip is clearly not subject to taxation. However, if the scrip was used to purchase dances, then the sale of such scrip would be subject to taxation.

B. A presumption of correctness attaches to a notice of determination upon its issuance (***see Matter of Hammerman***, Tax Appeals Tribunal, August 17, 1995). So long as it appears that a rational basis exists for the Division's determination, the burden is then placed upon petitioners to show, by clear and convincing evidence, that the audit method employed or the tax assessed is unreasonable ***(see Matter of Meskouris Bros. v Chu***, 139 AD2d 813 [3rd Dept 1988]; ***Matter of Surface Line Operators Fraternal Org. v Tully***, 85 AD2d 858 [3rd Dept 1981]). Here, petitioners have not met this burden. Petitioners' contention that scrip was not used to purchase private dances is contradicted by the documentary evidence in the record. Notwithstanding Mr. Zherka's testimony and the affidavits submitted by petitioners that allege that scrip could only be used for gratuities, all the contracts between the dancers and West 20th contained in the record consistently refer to dance fees and tips. In addition, several of the contracts required the dancer to charge the prevailing rate for table dances and/or private dances. In that same vein, petitioners' responsive pleadings in the Acevedo matter assert that the Club charged mandatory performance fees that were not tips. These documents are consistent with the Division's findings that upon visiting the Club, it was observed that in addition to room charges, private dances cost

$600.00 per hour in private rooms and $500.00 an hour in semi-private rooms. Here, while patrons of the Club may have used scrip to tip entertainers, it is clear that scrip was used to purchase dances.

C. No credence is given to the affidavits of Ms. Galan, Ms. O'Neill, Mrs. O'Neill, and Ms. Elliott. First, Mrs. O'Neil's claim that she was a "house mom" at the Club is directly contradicted by her deposition testimony in the Guzman FLSA action wherein she testified that she filled in at the Club only once. In addition, given her familial relationship to petitioner Dominica O'Neill, her credibility is questioned. With respect to Dominica O'Neill's affidavit, it is noted that she was present at the hearing but was not called to testify after specifically being afforded the opportunity to do so. In addition, the documentary evidence in the records coupled with the auditors' observations at the Club during the audits directly contradict the facts alleged in these affidavits. While it is acknowledged that affidavits are admissible under the Tax Appeals Tribunal's Rules of Practice and Procedure (***see*** 20 NYCRR 3000.15), these affidavits all seek to establish a critical fact at the heart of this matter, i.e., whether scrip was used to pay for dances or whether it was used solely for tipping. The presentation of critical facts through the introduction of affidavits denies the trier of fact the opportunity to observe and evaluate the affiants' credibility and to have their assertions tested by cross-examination (***see Matter of Orvis Co. v Tax Appeals*** Tribunal, 86 NY2d 165 [1995], ***cert denied*** 516 US 989 [1995]).

D. Tax Law § 1132 (c) (1) creates a presumption that all of a taxpayer's sales receipts are properly subject to tax until the taxpayer proves otherwise (Tax Law § 1132 [c] [1]; ***see Matter of Greystoke Industries LLC d/b/a/ Paradise Found***, Tax Appeals Tribunal, May 19, 2011). Petitioners have taken the position that all scrip was used for gratuities and have offered no evidence as to how much of the scrip sold was used for mandatory performance fees and how

much was used for tips. Sales for the use of scrip for such purchases has repeatedly been held to be subject to sales tax pursuant to Tax Law § 1105 (f) (1) and (3), and 1105 (d) (***see Matter of Marchello***, Tax Appeals Tribunal, April 14, 2011; ***Matter of HDV Manhattan, LLC,*** Tax Appeals Tribunal, February 12, 2016 ***confirmed Matter of HDV Manhattan, LLC v Tax Appeals Tribunal***, 156 AD3d 963 [3rd Dept 2017]; ***Matter of The Executive Club LLC***, Tax Appeals Tribunal, April 19, 2017; ***Matter of The Executive Club LLC and Gans,*** Tax Appeals Tribunal, July 24, 2019). In addition, any claim that the transaction fees on the processing of scrip are not subject to tax is also rejected. The Tax Law clearly provides that an admission charge "include[es] any service charge or any charge for entertainment or amusement or for the use of the facilities therefor" (Tax Law § 1101 [d] [2]). Based upon the foregoing, the Division properly asserted tax on the scrip sales. Pacific Club, as a vendor of scrip, was under a duty to collect and remit sales tax on such sales (***see*** Tax Law § 1131 [1]).

E. West 20th and Sushi Fun's arguments that because Pacific Club facilitated scrip conversion separate and apart from West 20th and Sushi Fun, they cannot be held liable for tax is rejected. Sales of scrip used for private dances are properly subject to sales tax even where the charges are collected by a separate entity (***see Matter of The Executive Club LLC***). Pacific Club was an integral part of the Club's operations. As Mr. Russell testified at the hearing, a Club patron did not differentiate between Sushi Fun, West 20th, or Pacific Club. The entities themselves did not differentiate either as each entity's sales were recorded in the same POS system. The claim that West 20th or Sushi Fun did not benefit in any way from the private dances defies credibility. The scrip was sold at the Club to its patrons; the transactions to purchase scrip via credit card were facilitated by the Club host and the scrip was purchased by the Club's patrons and used to purchase live entertainment offered by the Club through the

Club's dancers, who petitioners now concede were their employees. In essence, petitioners would like this forum to believe that the operators of an adult entertainment venue did not benefit from the "entertainment" that the patrons purchased at a premium in private and semi-private rooms. This notion is absurd and begs the question if the Club did not benefit, why did many of the "lease" contracts require the dancer to charge market rates for private dances?

F. Petitioner also asserts that should it be determined that sales tax is due on the sale of the scrip, the Division should be estopped from asserting same based upon previous audits of the Club and the related club in the Times Square matters. "[I]n order to impose an estoppel upon a party, three elements must be established: (i) conduct which amounts to a false representation or concealment of material facts; (ii) intention that such conduct will be acted upon by the other party; and (iii) knowledge of the real facts" (***Matter of Rashbaum v Tax Appeals Tribunal***, 229 AD2d 723, 725 [3rd Dept 1996]). In addition, the Division may not be estopped from asserting tax unless "unusual circumstances support a finding of manifest injustice" (***Matter of Salh v Tax Appeals Tribunal***, 99 AD3d 1124, 1126 [3rd Dept 2012], ***lv denied*** 20 NY3d 863 [2013], ***quoting Matter of Winners Garage, Inc. v Tax Appeals Tribunal***, 89 AD3d 1166, 1168-1169 [2011], ***lv denied*** 18 NY3d 807 [2012] [internal quotation marks and citations omitted].

Here, petitioners have not established that the Division should be estopped from asserting tax on the sale of scrip. First, petitioner has not made a showing that the Division misguided petitioners. There were no representations made by the Division wherein the Division advised petitioners that their sales of scrip used to pay mandatory performance fees is not subject to tax. No credence is given to Mr. Bobrow's version of events surrounding the issuance of the December 24, 2008 letter from Ms. Adsit-Vassari. His credibility is called into question by his declaration in the Romero action that the Division made certain written findings that the

transactions were not subject to sales tax and, as part of its findings, stated that the Division concluded that the dancers were neither independent contractors nor employees. Mr. Bobrow's characterization of this letter is embellishment at best. There were no such findings in that letter, nor does it state that the transactions were not subject to tax. The letter states that if the "unique business model" could be documented, then a refund would be granted. Obviously, the Division was eventually satisfied that the "unique business model" existed after further audit activity based on refunds being granted and warrant satisfactions filed. However, the claim that the VIP Club does not charge for private dances, which is the underpinning for the "unique business model" has been proven false in for the periods at issue herein. Moreover, petitioners' assertions that they relied on this letter is unavailing as results from prior audit periods are not binding on later audits (***see Matter of 677 New Loudon Corp. D/B/A Nite Moves***, Tax Appeals Tribunal, August 25, 2016 ["Each taxable period contested in a separate and distinct adjudication receives separate consideration from the adjudicator . . ."]; ***People ex rel. Watchtower Bible & Tract Socy. v Haring***, 286 AD 676, 680 [3rd Dept 1955], ***lv granted*** 11 AD2d 605 [3rd Dept 1960] ["(T)he assessment for one year is a separate and different cause of action from the assessment for another year"]; ***Matter of Winners Garage, Inc.***, Tax Appeals Tribunal, April 16, 2014 ["it is well established that audits are limited to the tax years at issue, and previous assessments and audits are non-binding upon future years"]).

G. Petitioners also assert that the assessments violate their rights to due process under the United States and New York State constitutions, alleging that it is impossible for them to comply with both the tax laws and labor laws. Petitioners' argument is that since the federal and state labor laws treat the dancers as employees, scrip is treated as gratuities and is not deemed to be a fee under the federal and state labor laws. Based on this assertion, petitioners contend the

notices should be cancelled. Petitioners' claims are again rejected. As a preliminary matter, petitioners do not specifically delineate how it is a due process violation to assert sales tax on fees charged for dances at an adult entertainment establishment, nor are any constitutional violations readily apparent. More importantly, whether the dancers are employees, independent contractors, or lessors of Club space has no bearing on the determination of whether the scrip was used to tip dancers, or whether the scrip was used to pay mandatory performance fees. Petitioners' argument is based on the proposition that the scrip was used solely for tipping, a proposition proven false, as discussed above.

H. Tax Law § 1145 (a) (1) (i) imposes a penalty for the failure to timely file a return or pay any tax imposed by articles 28 and 29 of the Tax Law. Penalties may be abated if such failure or delay was due to reasonable cause and not due to willful neglect (Tax Law § 1145 [a] [1] [iii]). Petitioners are requesting abatement of the penalties imposed on the notices of determination contending they have established reasonable cause based on their reliance on prior audit determinations wherein the Division either did not assess tax or refunded tax collected from them based upon the Club's "unique business model." After careful examination of the hearing record, it is concluded that petitioners have not met their burden of establishing reasonable cause for their failure to collect and remit sales tax on the sale of scrip at the Club. Their claims are, by definition, not reasonable given the falsehoods underpinning their arguments.

I. The petitions of West 20th Street Enterprises Corporation, Pacific Club Holdings, Inc., Sushi Fun Dining & Catering, Inc., and Dominica O'Neill, are denied, and the notices of determination dated August 30 and 31, 2016, are sustained.

DATED: Albany, New York
May 6, 2021

/s/ Kevin R. Law
ADMINISTRATIVE LAW JUDGE