STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition<br><br>of<br><br>**44TH ENTERPRISES CORPORATION**<br><br>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. | : | DETERMINATION<br>DTA NO. 828639 |
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| In the Matter of the Petition<br><br>of<br><br>**MLB ENTERPRISES CORPORATION**<br><br>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. | : | DTA NO. 828640 |

Petitioner, 44th Enterprises Corporation, filed a petition 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. Petitioner, MLB Enterprises Corporation, filed a petition 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.

A consolidated hearing was held before Barbara J. Russo, Administrative Law Judge, in New York, New York, on January 29, 2020, at 10:30 a.m., with all briefs to be submitted by August 20, 2020, which date began the six-month period for the issuance of this determination. 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).

## *ISSUES*

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

II. 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.

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

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

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

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

## *FINDINGS OF FACT*

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 contract between the dancers and MLB entered into the record 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." 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]

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,

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

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

[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 grnds*** 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.

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 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

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[4] Although petitioners' witnesses testified that scrip could not be used to pay for private room rentals, this testimony is contracted by petitioners' exhibit 43, which indicates that from at least January 2011 through October 2012 the Metro credit card "batch" amounts for scrip sales included charges for private rooms (***see*** finding of fact 21).

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, during the audit Mr. Capeci stated 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 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] 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

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

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]

12. Scrip could be used at the Clubs to purchase dances, tip dancers and waitresses,[8] and pay for entertainment in 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, during the audit he stated 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

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[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.

[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 in this matter.

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*** 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 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 petitioners described Exhibit 17 as an exemplar of Exhibits 42 and 43, a comparison of the exhibits reveals that Exhibit 17 is not reflective of the majority of documents contained in

Exhibits 42 and 43. Specifically, the ledgers in Exhibits 42 and 43 have some column captions that differ from Exhibit 17, 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, and a number of ledgers indicate that the Clubs' private room charges are included in Metro's credit card summary report totals, as discussed below.

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 December 2011, January 2012 through October 2012, December 2012, January 2013 through March 2013, May 2013 through November 2013, and January 2014 through December 2014. Exhibit 43 contains copies of ledgers for the periods January 2010 through November 2010, January 2011

through December 2011, January 2012 through May 2012, July 2012 through December 2012,[12] 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 ledgers are not labeled as MLB or 44th and there is no information in the record to determine which of the Clubs they pertain to. 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. 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 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

[12] Exhibit 43 contains two different ledgers for November 2012 showing entirely different entries for the same

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]

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dates. There is no explanation in the record as to which Club either book pertains or why there are two books for the same dates.

[13] For example, for June 15, 2013, the credit card batch report shows total charges of $41,796.00. The ledger shows two voucher numbers and amounts for “P/O” of 200 less 20, equaling 80, and 320 less 32, equaling 288, for a total of 468. The following page shows individuals’ names, and entries under the column L$, totaling 17,140 plus an unexplained 200, equaling 17,360. The % column shows a total of 1736 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.

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.

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

[14] ***See*** footnotes 7 and 11.
[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 records for the expanded audit period.

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 of the 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- 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 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,

[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).

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 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 IDRs 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 1.47%. 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 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 1.35%. The auditor multiplied gross sales reported ($4,698,852.00) 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:

> "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.[17]

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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[17] 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

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. Pursuant to 20 NYCRR 3000.15 (d) (6), petitioners submitted 40 proposed findings of fact. In accordance with State Administrative Procedure Act § 307 (1), proposed findings of fact 1, 6, 28, 32, 36, and 40 are supported by the record, and have been consolidated, condensed, combined, renumbered and substantially incorporated herein. Proposed findings of fact 2 through 5, 7, 8, 11 through 18, 21 through 27, 29, 31, and 33 through 35 have been modified to more accurately reflect the record and/or accepted in part and rejected in part as conclusory, irrelevant and/or not supported by the record; to the extent accepted they have been consolidated, condensed, combined, renumbered and substantially incorporated herein, as modified. Proposed findings of fact 9, 10, 19, 20, 30, and 37 through 39 are rejected as conclusory, irrelevant and/or not supported by the record.

## ***CONCLUSIONS OF LAW***

A. The first issue to be addressed is whether the sale of scrip at petitioners' Clubs is subject to tax.

> "As an initial matter, the question of whether payment for scrip sold used to purchase dances at an adult entertainment club is taxable as an 'amusement charge' or cabaret admission charge has been definitively answered in the affirmative in ***677 New Loudon*** and ***CMSG*** . . . . As noted, the Tax Appeals Tribunal has also repeatedly found that the sale of scrip to pay for dances and to make other payments at adult clubs constitute an amusement fee subject to sales tax" (***Metro Enterprises Corp. & Scarfi v New York State Dept. of Taxation and Finance***, Sup Ct, Albany County, August 29, 2017, Weinstein, J, Index No. 901347-17, citing ***Matter of 677 New Loudon Corp. v State of NY Tax Appeals Trib.***, 85 AD3d 1341 [3d Dept 2011], ***affd*** 19 NY3d 1058 [2012], ***cert denied*** 132 S Ct 422 [2013]; ***CMSG Rest. Group, LLC v State of New York***, 145 AD3d 136 [1st Dept 2016]; ***Matter of The Executive Club, LLC***, Tax Appeals Tribunal, April 19, 2017; ***Matter of HDV Manhattan***, ***LLC***, Tax Appeals Tribunal, February 12, 2016; ***Matter of Marchello***, Tax Appeals Tribunal, April 14, 2011).

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difference, nevertheless, is deemed inconsequential.

The evidence in this matter clearly establishes that the scrip sold at petitioners' Clubs was used to purchase dances and pay for other purchases by customers at those Clubs, such as private room rentals and drinks. As discussed herein, the sales of scrip at petitioners' Clubs are subject to sales tax pursuant to Tax Law §§ 1105 (f) (1), 1105 (f) (3) and 1105 (d).

B. Tax Law § 1105 (f) (1) provides that sales tax will be imposed on "[a]ny admission charge where such admission charge is in excess of ten cents to or for the use of any place of amusement in the state, except . . . dramatic or musical arts performances . . . ."

An admission charge is defined as "[t]he amount paid for admission, including any service charge and any charge for entertainment or amusement or for the use of facilities therefor" (Tax Law § 1101 [d] [2]). An amusement charge is defined as "[a]ny admission charge, dues or charge of roof garden, cabaret or other similar place" (Tax Law § 1101 [d] [3]). "Place of amusement" is defined as "[a]ny place where any facilities for entertainment, amusement, or sports are provided" (Tax Law § 1101 [d] [10]).

As noted above, New York courts and the Tax Appeals Tribunal have repeatedly held that the sale of scrip used to pay for exotic dances at adult entertainment clubs are subject to tax as admission or amusement charges (***see Matter of Marchello***, ["the sale of dance dollars . . . are properly taxable as amusement charges"]; ***Matter of HDV Manhattan, LLC***, ["the purchase of scrip to pay for a private dance constituted an admission charge within the meaning of Tax Law 1105 § (f) (1)"]; ***Matter of The Executive Club LLC and Gans***, Tax Appeals Tribunal, July 24, 2019 [receipts from the sale of scrip are taxable "as admission charges to a place of amusement and sales tax is collectable at the time the customer purchases the executive dollars"]).

The evidence clearly establishes that the scrip sold at petitioners' Clubs was sold by petitioners' employees and was used to purchase exotic dances offered by petitioners to customers at those clubs. The evidence further establishes that scrip was also used by

petitioners' customers to pay for private room charges and entertainment in the private rooms. Such charges are subject to tax as amusement charges (***see Matter of The Executive Club LLC and Gans***; ***Matter of HDV Manhattan, LLC***).

Moreover, the scrip sales for dances and private room charges are properly subject to sales tax even where the charges are collected by a separate entity (***see Matter of The Executive Club LLC***). In ***Matter of The Executive Club***, the Tribunal compared the circumstances in that case to those in ***Matter of HDV Manhattan***, and noted:

> "It was concluded in ***Matter of HDV Manhattan, LLC*** that because of both the club's control over the transactions at issue and financial interest in those transactions, it was the club, and not the entertainers, that was responsible to collect the sales tax. As pertains to this argument, there do exist some relevant factors that differ between the present case and ***Matter of HDV Manhattan, LLC***. For example, the Club in the present case does not receive the receipts from the charges for the use of the private rooms as the club in ***Matter of HDV Manhattan, LLC*** did; a separate corporation receives those receipts. However, there are more than enough similarities to find that the Club is indeed responsible for the collection of the sales taxes on the receipts from the admission charges for the personal dances. Specifically, the Club provided initial access to the public rooms (from which the private rooms could be accessed) and scrip for purchase that could be used to purchase the personal dances, and controlled the minimum prices that could be charged for the personal dances. Furthermore, the Club derived revenue from the scrip sold through both the surcharge it charged its customers and the redemption fees it charged the entertainers" (***Matter of The Executive Club LLC***).

Similar to the facts in ***Matter of The Executive Club***, while the scrip transactions here were processed through Metro's credit card terminals (although as conceded by petitioners, also processed on their terminals on occasion), the Clubs here provided initial access to the public rooms from which the private rooms could be accessed, offered dances to its customers in both public and private rooms, and offered scrip for purchase that could be used to purchase the personal dances and private rooms, and controlled the minimum prices that could be charged for the personal dances. Furthermore, the Clubs derived revenue from the scrip sold from both the rooms charges and fees collected from the dancers. As such, the charges for scrip transactions

which were then used to pay for private rooms and dances are properly subject to sales tax as admission or amusement charges.

C. The sale of scrip at petitioners' Clubs is also subject to sales tax pursuant to Tax Law § 1105 (f) (3). Pursuant to Tax Law § 1105 (f) (3), "[t]he amount paid as charges of a roof garden, cabaret or other similar place in the state" is subject to sales tax. The terms "roof garden, cabaret or other similar place" are defined as:

> "[a]ny roof garden, cabaret or other similar place which furnishes a public performance for profit, but not including a place where merely live dramatic or musical art performances are offered in conjunction with the serving or selling of food, refreshment or merchandise, so long as such serving or selling of food, refreshment or merchandise is merely incidental to such performances" (Tax Law § 1101 [d] [12]).

A "charge of a roof garden, cabaret or other similar place" means "[a]ny charge made for admission, refreshment, service, or merchandise at a roof garden, cabaret or other similar place" (Tax Law § 1101 [d] [4]) and, under the pertinent regulation, includes charges for "music or entertainment . . . [or] service" (20 NYCRR 527.12 [b] [1] ).

In ***Matter of HDV Manhattan, LLC***, the Tribunal found that the club's sale of scrip was alternatively taxable under Tax Law § 1105 (f) (3). In its review of the Tribunal's decision, the Appellate Division stated:

> "The Tribunal explicitly found that the club furnished public performances for profit through its offerings of stage dances and table dances and, therefore, qualified as a cabaret or similar place within the meaning of Tax Law § 1105 (f) (3).
>
> This finding is certainly supported by the record, as there was ample testimony that entertainers would perform on one of three public stages in the main area of the club or tableside at one of the many tables surrounding the stages, all of which were viewable to patrons who paid general admission into the club. Accordingly, the Tribunal rationally concluded that the club is a cabaret or other similar place—that is, a place which furnishes public performances for profit (***see*** Tax Law §§ 1105[f][3]; 1101[d][12]; ***Matter of 677 New Loudon Corp. v. State of N.Y. Tax Appeals Trib***., 85 A.D.3d at 1346, 925 N.Y.S.2d 686). Additionally, given that 'charges of a ... cabaret or other similar place' include service and entertainment charges (***see*** Tax Law § 1101[d][4]; 20 NYCRR 527.12[b][1] ), the

> revenue generated from the sale of scrip—which could be used to tip or purchase table dances and/or private dances—is properly taxable under Tax Law § 1105(f)(3).
>
> Petitioners argue, however, that the sale of scrip qualifies for the exclusion set forth in Tax Law § 1105(f)(3) because it is 'a place where merely live dramatic or musical arts performances are offered in conjunction with the serving or selling of ... refreshment or merchandise' and 'such serving or selling ... is merely incidental to such performances' (Tax Law § 1101[d] [12] ). The Tribunal found that, while public performances for profit were offered in the main area of the club, the club also offered nonpublic performances in the form of private dances in one of the club's 16 private rooms, which were viewable only to the paying customer. This finding is both rational, as the Tribunal afforded the word 'public' its plain and ordinary meaning in reaching its conclusion that the private dances were nonpublic performances, and fully supported by the record. Considering that, as established by the record, the private dances made up a significant portion of the club's 'entertainment offerings,' a rational basis exists for the Tribunal's further determination that, even if the stage performances and table dances were live dramatic or musical arts performances, the club did not 'merely' offer such performances, so as to bring the sale of scrip within the ambit of the exclusion (Tax Law § 1101[d][12]). As such, we discern no basis on which to disturb the Tribunal's determination that the exclusion set forth in Tax Law § 1105(f)(3) is inapplicable" (***HDV Manhattan, LLC v. Tax Appeals Tribunal***, 156 A.D.3d 963 [3d Dept 2017]).

Petitioners have failed to distinguish this matter from the holding of ***Matter of HDV Manhattan, LLC***. In both cases, the clubs offered public performances for profit in the main area of the clubs and personal interactions with the entertainers in the public areas, all of which were viewable to patrons who paid general admission into the club, as well as nonpublic performances in the form of private dances in the Clubs' many private rooms, which were viewable only to the paying customer. Similar to the situation in ***Matter of HDV Manhattan, LLC***, the record here likewise establishes that the private dances made up a significant portion of the Clubs' entertainment offerings. As such, the Clubs qualified as a cabaret or similar place within the meaning of Tax Law § 1105 (f) (3). As it is determined that petitioners' Clubs are a cabaret or similar place, *any* charges made for admission, entertainment, refreshment, service, etc. are subject to tax (***see*** Tax Law § 1101 [d] [4]; 20 NYCRR 527.12 [b] [1] ). Moreover, petitioners have failed to establish that the Clubs "merely" offer such performances in

conjunction with the serving or selling of food, refreshment or merchandise that was merely incidental to such performances so as to bring the sale of scrip within the ambit of the exclusion (***see*** Tax Law § 1101 [d] [12]). Accordingly, all of petitioners' charges are subject to tax under Tax Law § 1105 (f) (3).

D. Petitioners' charges for beverages, cover, minimum, entertainment, and other charges, including charges for the sales of scrip at the Clubs are also subject to sales tax pursuant to Tax Law § 1105 (d), which imposes sales tax on:

> "(i) The receipts from every sale of beer, wine or other alcoholic beverages or any other drink of any nature, or from every sale of food and drink of any nature or of food alone, when sold in or by restaurants, taverns or other establishments in this state, or by caterers, *including in the amount of such receipts any cover, minimum, entertainment or other charge made to patrons or customers* (except those receipts taxed pursuant to subdivision (f) of this section):
>
> (1) in all instances where the sale is for consumption on the premises where sold" (emphasis added).

In ***Matter of 677 New Loudon Corp. d/b/a Nite Moves***, the Tribunal found that admission charges of an adult entertainment venue were subject to sales tax pursuant to Tax Law § 1105 (d), stating:

> "We agree with the Division that such charges could be subject to tax under Tax Law § 1105 (d) in the alternative. We view the limiting language of Tax Law § 1105(d) (i), limiting tax under this section to receipts not taxed under subdivision 'f' of this section, as merely to protect taxpayers against double taxation. Further, we find the Administrative Law Judge erred in opining that this provision would apply only in situations where petitioner's drinks were extraordinary and were the primary reason for patrons to frequent Nite Moves. The Administrative Law Judge completely ignored the broadly inclusive language of subdivision (d), i.e., '*including in the amount of such receipts any cover, minimum, entertainment or other charge* made to patrons . . .(emphasis added).'"

There is no dispute that during the period at issue, petitioners sold beverages at the Clubs and charged an admission or cover charge that allowed patrons entry into the Clubs to view performances in the main area of the Clubs. Petitioners remitted some sales tax on these charges and have failed to meet their burden of proving that the Division's determination that

additional tax was due on these areas was erroneous. Further, the record shows that contrary to petitioners' witnesses' testimony, scrip was used to purchase beverages in the Clubs, and the sale of scrip for such purchases are also subject to tax.

Customers paid a separate admission fee for entertainment offered in private rooms at the Clubs. Like the general admission charges, the admission charges for customers' use of the private rooms are "cover, minimum, entertainment or other charge" (Tax Law § 1105 [d] [i]) collected by an establishment serving beverages and are subject to tax (***see Matter of 677 New Loudon***; ***Matter of Marchello***; ***Matter of Executive Club and Gans***). The evidence in the record establishes that scrip was used to purchase admission to private rooms and pay for the company of entertainers in the private rooms. As discussed herein, petitioners have failed to establish what amount, if any, of the scrip was used for nontaxable purposes. As such, petitioners have not met their burden of proving that receipts from the sales of scrip are not taxable as "any cover, minimum, entertainment or other charges . . ." pursuant to Tax Law § 1105 (d).

E. Petitioners argue that the purchase of scrip by customers at their clubs was not subject to sales tax, claiming that the scrip was used "solely for voluntary gratuities." Petitioners' contention that scrip was not used to purchase private dances is contradicted by both the testimony and the documentary evidence in the record. Additionally, the testimony of petitioners' witnesses that scrip could only be used for voluntary gratuities is directly contradicted by the evidence and is found to lack credibility. The overwhelming evidence in the record shows that the Clubs sold dances and that scrip could be used to purchase dances, both in the main room and in private rooms of the Clubs. The ledgers presented by petitioners show that scrip purchases were also used for private room rentals, and do not support petitioners' claim that the full amount of scrip purchased by customers was redeemed by the dancers.

The scrip was sold at the Clubs to petitioners' customers; the transactions to purchase scrip via credit card were conducted by petitioners' employees, and the scrip was purchased by the Clubs' patrons and used to purchase live entertainment offered by the Clubs through the Clubs' dancers, who petitioners now concede were their employees. Petitioners admittedly set a minimum price for exotic dances at the Clubs, charging a minimum of $20.00 for dances in the main room and, according to the manager of MLB, charged between $160.00 to $900.00 for a ten minute dance in the private rooms. The fact that petitioners set the prices for dances directly contradicts their argument that they did not sell dances and that customers' payments for such dances were entirely voluntary. Additionally, contrary to the testimony of Mr. Capeci and Mr. Scarfi, the evidence shows that scrip could also be used to rent private party rooms, pay the dancer's fee to go in the private rooms, and pay for drinks. Sales for the use of scrip for such purchases has repeatedly been held as subject to tax pursuant to Tax Law § 1105 (f) (1) and (3), and 1105 (d) (***see Matter of Marchello***; ***Matter of HDV Manhattan, LLC***; ***Matter of The Executive Club LLC***, ***Matter of The Executive Club LLC and Gans***). The surcharges and transaction fees on the processing of scrip are likewise subject to sales tax (***see*** Tax Law § 1101 [d] [2]).

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). Furthermore, a presumption of correctness attaches to statutory notices (Tax Law § 689; ***see also Matter of Tavolacci v State Tax Commn.***, 77 AD2d 759 [1980]), and petitioners bear the burden of overcoming this presumption (***see Executive Club I***; ***Matter of HDV Manhattan, LLC***). Petitioners have failed to overcome this presumption.

F. Petitioners' reliance on the Labor Law and Fair Labor Standards Act as support for their

contention that that the scrip was used only for voluntary gratuities and was not subject to sales tax is rejected as meritless. Petitioners' argument that they could not retain any portion of the scrip under the Labor Law and Fair Labor Standards act because the scrip was solely meant as a gratuity fails on two grounds: it is based on the premises that 1) the scrip was used solely as voluntary gratuity and 2) petitioners did not actually retain any portion of the scrip proceeds. The record shows that both premises are, in actuality, false.

First, while petitioners contend that under the Labor Law and Fair Labor Standards Act, employers cannot retain employee gratuities, they have failed to show what amount, if any, of the scrip was actually a voluntary gratuity given to the dancers. As discussed above, the evidence contradicts petitioners' assertion that payments from customers to dancers were "voluntary" and instead shows that scrip was used for the purchase of dances, to pay the required "minimum" for such dances, to pay for the use of private rooms, to pay the dancer's fee in the private room, and to purchase beverages, in addition to possible tips. Having failed to present evidence distinguishing how much of the scrip was used for dance fees, rooms, and other charges, as opposed to tips, petitioners have failed to meet their burden of proving what amount of scrip was actually paid over to the dancers as tips (***see Matter of Executive Club and Gans*** [holding that the administrative law judge correctly concluded that petitioners failed to meet their burden of proving the amount of tips based upon the unconvincing nature of such records and the contradictory nature of the evidence]).

Second, the record clearly shows that contrary to petitioners' contention, they did not pay the full amount of scrip purchased by customers to the dancers. The records presented by petitioners in Exhibits 17, 42 and 43 do not support their claim that the dancers redeemed the full amount of scrip purchased by the customers. The totals on the credit card summary reports attached to the Clubs' ledgers do not reconcile with the scrip and lace dollar amounts purportedly

redeemed by the dancers.[18] The evidence further establishes that from the amounts of scrip that were redeemed by dancers, in addition to deducting the redemption fee, the Clubs deducted and retained other charges such as house fees, rent, and late charges, as admitted by 44th and Mr. Capeci in the ***Dennis*** matter admissions (***see*** finding of fact 4). Indeed, their admissions and affirmative statement in the ***Dennis*** answer that "some or all of the payments received by [the dancers] for performances were administrative charges, which a reasonable customer should understand were not gratuities" are incongruous with their position here. As such, petitioners have failed to meet their burden of proving what amount of scrip was paid over to the dancers as voluntary gratuities.

It is worth noting that Mr. Capeci and Mr. Scarfi both admitted, respectively, that petitioners' business model and Metro's business model were created in an effort to avoid employment tax issues and labor law obligations (***see*** finding of fact 33). Petitioners cannot now hide behind the Labor Law to avoid sales tax obligations. Petitioners are not excused from collecting and remitting sales tax merely because they structured their business in such a way to attempt to avoid employment tax and labor law requirements.

G. Having determined that the sale of scrip at petitioners' clubs is subject to sales tax pursuant to Tax Law §§ 1105 (d), 1105 (f) (1) and 1105 (f) (3), the next question is whether petitioners were responsible persons required to collect and remit the sales tax. Persons required to collect tax under these provisions include "every vendor of tangible personal property or services" and "every recipient of amusement charges" (Tax Law § 1131 [1]). A recipient is defined as "[a]ny person who collects or receives or is under a duty to collect an amusement charge" (Tax Law § 1101 [d] [11]). For purposes of taxes imposed under Tax Law § 1105 (f),

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[18] While petitioners contend that the books are Metro's ledgers, there is no dispute that the ledgers were created by petitioners' employees for credit card purchases of scrip at the Clubs, and that the transactions

an amusement charge is defined as "[a]ny admission charge, dues or charge of roof garden, cabaret or other similar place" (Tax Law § 1101 [d] [3]), and admission charge, in turn, is defined as "the amount paid for admission, including any service charge and any charge for entertainment or amusement or for the use of facilities therefor" (Tax Law § 1101 [d] [2]). The term "person" includes corporations (Tax Law § 1101 [a]).

Petitioners are recipients of amusement charges as defined by (Tax Law § 1101 [d] [11]). As discussed above, the sale of scrip to purchase dances and make other payments at the Clubs are amusement and admission charges. Petitioners, through their employees collected the amusement and admission charges: they sold the scrip to patrons, 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. As such, petitioners are the recipients of amusement charges and are persons required to collect tax on such charges pursuant to Tax Law § 1131 (1).

Petitioners are also "vendors" required to collect tax pursuant to Tax Law § 1131 (1). The term "vendor" includes, in part, a person making sales of tangible personal property or services the receipts from which are taxed under article 28 of the Tax Law, a person maintaining a place of business in the state and making sales of tangible personal property or services taxable under article 28, and a person who solicits business either by employees, independent contractors, agents or other representatives (Tax Law § 1101 [b] [8] [i] [A], [B], and [C]). The term "person" includes "an individual, partnership, limited liability company, society, association, joint stock company, corporation, estate, receiver, trustee, assignee, referee, and any other person acting in a fiduciary or representative capacity . . ." (Tax Law § 1101 [a]).

Petitioners fall within the definition of vendor. As discussed above, petitioners were

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were conducted by petitioners' employees.

making sales at the Clubs that are taxable under article 28 of the Tax Law. Petitioners sold entrance admissions, taxable beverages, exotic dances, entertainment in private rooms, and scrip used by customers to make such purchases. As such, petitioners are "vendors" as defined by Tax Law § 1101 (b) (8) and are persons required to collect tax pursuant to Tax Law § 1131 (1).

Petitioners argument that they are not responsible for the collection and payment of taxes on the sale of scrip because the transactions for scrip were run on credit card terminals maintained by Metro and the receipts for the transactions were reflected in Metro's bank deposits and not petitioners is rejected. The Tribunal has rejected similar arguments and held that the use of a third party to manage and collect receipts does not affect the basis for the imposition of tax (***see Matter of Marchello***; ***Matter of Executive Club***).

Furthermore, contrary to petitioners' argument that "[i]t was Metro's exclusive responsibility to exchange customers' credit card payments into scrip vouchers and then redeem the vouchers into cash," the record shows that petitioners' employees were responsible for every step of the scrip transactions: petitioners' employees sold the scrip to customers, ran the credit card transactions for the purchase of scrip, exchanged the scrip for cash, and recorded the scrip transactions in the daily ledgers.

Additionally, the record shows that petitioners and Metro commingled accounts and transactions in that they both concededly used each other's credit card terminals, charges processed by Metro included transactions for the Clubs' room rentals, Mr. Capeci had check signing authority for Metro and Mr. Scarfi had check signing authority for MLB and 44th, Mr. Capeci signed checks on behalf of Metro and Mr. Scarfi wrote checks to petitioners' employees from Metro's account.

H. Petitioners have failed to meet their burden of proving that the Division's determination of additional tax due on receipts from sales of door admissions, coat check, room rentals and

beverages was erroneous.

Tax Law § 1135 (a) (1) provides that "[e]very person required to collect tax shall keep records of every sale . . . and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the commissioner of taxation and finance may by regulation require." Such records include a "copy of each sales slip, invoice, receipt, statement or memorandum upon which subdivision (a) of section eleven hundred thirty-two requires that the tax be stated separately" (Tax Law § 1135 [a] [1]; 20 NYCRR 533.2 [b] [1]).

Tax Law § 1138 (a) (1) provides, in relevant part, that if a sales tax return is not filed, "or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the [Division] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . ." (Tax Law § 1138 [a] [1]). When acting pursuant to section 1138 (a) (1), the Division is required to select an audit methodology reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the audit methodology or the amount of the assessment was erroneous (***see Matter of Your Own Choice, Inc.***, Tax Appeals Tribunal, February 20, 2003).

The standard for reviewing a sales tax audit where an indirect audit methodology has been employed in the determination of sales tax liability is well established, and was set forth in ***Matter of AGDN, Inc***. (Tax Appeals Tribunal, February 6, 1997), as follows:

> "a vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (***see***, Tax Law §§ 1138[a]; 1135; 1142[5]; ***see***, ***e.g.***, ***Matter of Mera Delicatessen***, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . .' (Tax Law § 1138[a]; ***see, Matter of Chartair, Inc. v. State Tax Commn.***, 65

> AD2d 44, 411 NYS2d 41, 43). When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (***Matter of Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869); exactness is not required (***Matter of Meyer v. State Tax Commn***., 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025; ***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451)."

In this case, the record establishes the Division's numerous clear and unequivocal written and oral requests for books and records of petitioners' sales, as well as petitioners' failure to produce such books and records. Based on the lack of records provided, the Division reasonably concluded that petitioners did not maintain or have available books and records that were sufficient to verify gross and taxable sales for the audit period. Having established the unavailability of required books and records, the Division was clearly entitled to estimate the tax from the information available in order to determine petitioners' sales and sales tax liability.

Based on the information gathered during the audit, the Division's auditors determined that petitioners did not use cash register tapes, sales invoices or other source documents to report their sales tax liability. Instead, petitioners used bank deposits to prepare the Clubs' tax returns. After comparing sales contained in available point of sale records to sales reported by petitioners for the quarter ending November 30, 2013, the Division determined that the Clubs had not properly reported the amount of tax due for that quarter. To determine whether the Clubs had paid the proper amount of tax due for the audit period, for each of the Clubs the Division added their 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 for that quarter. The Clubs did not separately state sales tax on its invoices. Therefore, to determine audited sales, the auditor subtracted tax remitted for that quarter from audited gross receipts and determined

audited gross sales for each of the Clubs for the quarter. The auditor divided audited gross sales by gross sales reported by the Clubs for that quarter to determine an error rate for each club. The auditor then multiplied gross sales reported by each Club by the error rate to determine audited gross sales, additional gross sales, and tax due from each Club for the period at issue from their door admissions, coat check, bar sales and room rentals.

Petitioners have the burden of establishing that the audit method employed was unreasonable or that the amount of tax assessed as the result of the application of the method used in this case was erroneous (***see Matter of Surface Line Operators Fraternal Org. v Tully***). Petitioners have not met this burden.

Furthermore, petitioners' argument that the Division should not have included room rentals in its calculation of taxable sales is rejected. Petitioners have presented no evidence, other than Mr. Capeci's self-serving and incredible testimony, that private rooms could be rented without an accompanying dancer. Mr. Capeci's claim is contradicted by information gathered by the auditors and investigators during the audit that the private rooms were used for customers to obtain private performances from the dancers. Assuming, arguendo, that a room was rented without an accompanying private dance, petitioners have failed to present evidence distinguishing which rentals were accompanied with dances and which were not. As petitioners bear the burden of proof, their argument in this regard fails.

I. Petitioners argue that the Division should be estopped from assessing sales tax against them for the period at issue, contending that they detrimentally relied on prior audits and statements made by the Division, and further that the Division violated the State Administrative Procedure Act.

The doctrine of equitable estoppel may be invoked against a government agency charged with the administration of taxes only where exceptional circumstances are present and

application of the doctrine is necessary to prevent a manifest injustice (***see Matter of Sodexho, USA, Inc.***, Tax Appeals Tribunal, November 21, 2007). In order for the doctrine to apply in a specific case, it must be established that: (1) there was a misrepresentation made by the government to a party and the government had reason to believe that the party would rely upon the misrepresentation; (2) the party's reliance on the government's misrepresentation was reasonable; and (3) prior to the party discovering the truth, the party acted to its detriment based upon the misrepresentation (***see Matter of Casa Di Pizza, Inc.***, Tax Appeals Tribunal, November 12, 2015; ***Matter of Ryan***, Tax Appeals Tribunal, September 12, 2013).

Petitioners assert that equitable estoppel should apply based on their claim that the Division previously audited petitioners for a prior period of March 2007 to February 2010 and had not asserted that tax was due from petitioners for the sale of scrip during the prior audit, even though petitioners had the same business arrangement with Metro then as they do now. Petitioners further contend that equitable estoppel is proper based on the Division's conduct of audits of other adult nightclubs with similar business operations as petitioners' Clubs and third-party scrip issuers similar to Metro, in which petitioners claim the Division did not assert tax due on the sale of scrip. Specifically, petitioners maintain that they reasonably relied, to their detriment, on prior audit results of West 20th Enterprises Corp. (West 20th), which was another entity that had previously been operated by Mr. Capeci, and Pacific Club Services Corp. (PCS), Metro's predecessor.

It is well settled that each tax period stands on its own, and results from prior audit periods are not binding on later audits (***see Matter of 677 New Loudon Corp. D/B/A Nite Moves*** ["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 [1955], ***lv granted*** 11 AD2d 605 [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"]). As petitioners rely on audits from prior periods and other non-party taxpayers, their argument for estoppel is rejected.

Petitioners further argue that the Division "adopted a policy that scrip is always subject to sales tax" in violation of the State Administrative Procedure Act. Contrary to petitioners' argument, the testimony of Mr. Carzo and Ms. Scala, as well as the documentary evidence, show that the Division did not maintain such a "policy" and that rather determinations are made on a case by case basis. In this case, petitioners failed to provide proof to show that the scrip was used solely for voluntary gratuities.

J. Petitioners assert that the assessments violate their constitutional rights under the federal and state constitutions, contending that "the Department's issuance of assessments violated Petitioners [sic] due process rights under the U.S. and New York State Constitutions by making it impossible for Petitioners to comply with both the tax laws and labor laws." To the extent that petitioners' argument challenges the constitutionality of the applicable provisions of the Tax Law on its face, the Division of Tax Appeals lacks jurisdiction over such constitutional challenges, and statutes are presumed to be constitutional on their face (***see Matter of Eisenstein***, Tax Appeals Tribunal, March 27, 2003; ***see also Matter of Geneva Pennysaver***, Tax Appeals Tribunal, September 11, 1989; ***Matter of Fourth Day Enters.***, Tax Appeals Tribunal, October 27, 1988). To the extent that petitioners raise a constitutional challenge on an "as applied" basis, their argument is rejected as meritless. First, petitioners' argument must fail as they have failed to meet their burden of proving that the Division applied the Tax Law to petitioners in a manner different than any other similarly situated taxpayer (***see Matter of HDV Manhattan***,

***LLC***; ***Matter of Finch, Pruyn & Co., Inc.***, Tax Appeals Tribunal, April 22, 2004). Second, petitioners' argument that the Division's assessment violates petitioners' due process rights "by making it impossible for Petitioners to comply with both the tax laws and labor laws," based on petitioners' groundless assertion that the scrip was paid to dancers as voluntary gratuities, is without merit. As discussed above, there is no support in the record for petitioners' claim that scrip was used solely for voluntary gratuities. Furthermore, petitioners' contention that they structured their business in such a way that they did not compensate their employees through wages or salary and are now subject to a lawsuit in that regard does not relieve them of their obligations to pay the proper amount of sales tax. As such, petitioners' constitutional arguments are rejected.

K. While petitioners did not specifically raise the issue of the Division's assertion of penalties, such issue will be addressed herein. The Division asserted penalties against petitioners pursuant to Tax Law §§ 1145 (a) (1) (i) and 1145 (i).

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]). Consistent with this statute, the regulations provide that penalty imposed under Tax Law § 1145(a) (1) (i) "must be imposed unless it is shown that such failure was due to reasonable cause and not due to willful neglect" (20 NYCRR 2392.1 [a] [1]).

Petitioners bear the burden of proving that the failure to report and pay the required amount of sales tax was due to reasonable cause and not due to willful neglect (***see Matter of MCI Telecommunications Corp.***, Tax Appeals Tribunal, January 16, 1992). "By first requiring the imposition of penalties (rather than merely allowing them at the

Commissioner's discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation" (***Matter of MCI Telecommunications, Corp.***, Tax Appeals Tribunal, January 16, 1992). The taxpayer faces the "onerous task" of establishing reasonable cause as well as the absence of willful neglect (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). Petitioners here have not established reasonable cause and have failed to meet this burden.

Tax Law § 1145 (i) imposes additional penalties for failure to maintain or make available sales tax records to the Division. Such provision provides for a penalty of up to $1,000.00 for the first quarter or part thereof for which the failure occurs, and not to exceed $5,000.00 for each additional quarterly period or part thereof for which the failure occurs. Such penalties may be abated if petitioners prove that such failure to maintain and produce records was due to reasonable cause and not willful neglect (Tax Law § 1145 [i]).

Petitioners have failed to meet their burden of proving that their failure to maintain and produce requested books and records was due to reasonable cause and not due to willful neglect. As discussed above, the Division made numerous oral and written requests for petitioners' books and records. Despite the Division's granting of petitioners' numerous requests for extensions and delays to produce the requested records, petitioners failed to provide all of the records requested, and those that were provided were incomplete. Additionally, the auditor's field audit log, which was contemporaneously maintained during the audit, reflects that petitioners' principal, Mr. Capeci, was often uncooperative and at times belligerent during the audit. As petitioners have presented no evidence to show that their failure to maintain and produce the

requested books and records was due to reasonable cause and not willful neglect, the imposition of such penalties is proper.

L. The petitions of 44th Enterprises Corporation and MLB Enterprises Corporation are denied, and the notices of determination dated November 30, 2016 are sustained.

DATED: Albany, New York
February 18, 2021

/s/ Barbara J. Russo
ADMINISTRATIVE LAW JUDGE