STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
FRANK A. MARCHELLO (DECEASED)	:	DECISION DTA NO. 821443
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1995 through August 31, 2002.	:	

Petitioner, Frank A. Marchello (deceased),[1] and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on November 19, 2009. Petitioner appeared by Hodgson Russ, LLP (Joseph N. Endres, Esq., Timothy P. Noonan, Esq., and Alvan Bobrow, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioner filed a brief in support of his exception and a brief in opposition to the Division of Taxation's exception. The Division of Taxation filed a brief in support of its exception and in opposition to petitioner's exception. Petitioner and the Division of Taxation each filed reply briefs. Oral argument, at the request of both parties, was heard on October 20, 2010, in Troy, New York.

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

[1] Frank A. Marchello passed away on January 29, 2002, in New Jersey. William Fleming, the appointed executor of his estate, filed the underlying petition in this matter.

ISSUES

I. Whether the Division of Tax Appeals lacks jurisdiction to consider the underlying issues because the statutory notice was issued to Frank A. Marchello rather than to his estate.

II. Whether the Notice of Determination should be cancelled because there is no underlying corporate liability.

III. Whether the Notice of Determination issued to Frank A. Marchello should be cancelled because it lacks a rational basis.

IV. Whether Frank A. Marchello is liable for the sales and use taxes due from Club V.I.P. of N.Y., Inc., as a person responsible for the collection and payment of sales tax pursuant to Tax Law §§ 1131 and 1133.

V. Whether the audit method employed by the Division of Taxation in its audit of Club V.I.P., Inc., was reasonable or whether petitioner has shown error in either the audit method or result.

VI. Whether petitioner presented grounds for the abatement of penalty asserted in the subject Notice of Determination.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "5," "6," "7," "8," "11," "12," "13," "21," "22," "23," "24," "26," "27," "28," "29," "30," "31," "32," "33," "34," "53" and "57," which have been modified. We have omitted findings of fact "3" and "4" because these facts are immaterial to the instant matter. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

On February 10, 2005, the Division of Taxation (Division) issued to Frank A. Marchello

a Notice of Determination (L-025022670), assessing $4,369,607.69 in sales and use taxes due, plus penalty and interest, for the period December 1, 1995 through August 31, 2002. The notice indicated that Mr. Marchello was being held liable as an officer or responsible person of Club V.I.P. of N.Y. Inc. (Club VIP).

Club VIP, along with two other corporations, managed the operations of an adult entertainment night club, whose trade name was the "VIP Club of NY" (the "VIP Club" or the "club"), located at 20 West 20th Street, New York, New York, during the period December 1, 1995 through August 31, 2002. The VIP Club served food and beverages and provided adult entertainment during the period at issue.

We modify finding of fact "5" of the Administrative Law Judge's determination to read as follows:

> Petitioner, Frank A. Marchello, owned a company called "A" Street Entertainment, Inc. ("A" Street or ASEC), which was established to sponsor aspiring singers and produce music videos. Mr. Marchello was the sole owner and director of "A" Street, a New Jersey domestic profit corporation incorporated on February 28, 1985, whose principal business address was Old Camplain Road, Somerville, New Jersey. "A" Street was not successful and ultimately ceased operating as an entertainment company. Mr. Marchello, however, continued to hold the company as a dormant entity.[2]

We modify finding of fact "6" of the Administrative Law Judge's determination to read as follows:

> In January 1993, Mr. Marchello decided to open a gentlemen's (i.e., adult entertainment) club in New York City and acquired a company called Dezer Entertainment Concepts, Inc. (Dezer Entertainment or DEC) from an unrelated third party, Michael Dezer. Dezer Entertainment held cabaret and liquor licenses, which were needed to run the club. Mr. Marchello purchased Dezer Entertainment through "A" Street, such that "A" Street became the sole owner of

[2] We modify this fact to remove language referring to the omitted irrelevant findings.

> Dezer Entertainment. Thereafter, Dezer Entertainment entered into a ten-year lease agreement, dated January 6, 1993, with Dezer Properties, Inc., to lease premises for the club at 20 West 20th Street in Manhattan. With the lease and licenses in place, Mr. Marchello began to operate the club, which initially went by the trade name "Texas Gold." Mr. Marchello operated Texas Gold via a wholly-owned corporation called Tex-Mex Restaurant Corp. When Texas Gold failed to do as well as Mr. Marchello had hoped, it was shut down and reopened under the trade name "Silverado."[3]

We modify finding of fact "7" of the Administrative Law Judge's determination to read as follows:

> By 1995, Mr. Marchello had invested a large amount of money in the club, including expenditures for furniture, fixtures and equipment, as well as to renovate and improve the club's premises. Also, petitioner, through Dezer Entertainment, held the balance of a 10-year lease for the club's premises. Mr. Marchello was looking for someone with experience in the industry to manage the club so that the club would continue to operate and become successful.[4]

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> In or about January 1996, Mr. Marchello made an agreement with Steve Aslan and Jon Vargo, both of whom had experience in the adult entertainment industry, to take over the operations of Silverado. Under their agreement, which was first verbal, Mr. Aslan and Mr. Vargo were to manage the gentlemen's club located at 20 West 20th Street and pay all expenses associated with the operations of the club.[5]

After taking control of Silverado, Mr. Aslan and Mr. Vargo changed the trade name of the club to the VIP Club. At the advice of his accountant, Mr. Aslan also set up three companies to manage the day-to-day operations of the VIP Club. These entities were 20/20 Food & Beverage, Inc. (20/20), incorporated in New York State on February 7, 1996, Prestige Food & Beverage,

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[3] We modify this fact to more accurately reflect the record.

[4] We modify this fact to more accurately reflect the record.

[5] We modify this fact to more accurately reflect the record.

Inc. (Prestige), incorporated in New York State on February 20, 1996, and Club VIP, incorporated in New York State on February 20, 1996. Mr. Aslan's accountant advised him to structure the VIP Club's operations in this manner so that its nontaxable receipts would be segregated from its taxable receipts. Mr. Aslan's accountant, based on his understanding and experience from having worked in the industry, advised Mr. Aslan that any receipts generated only from the sale of exotic dances would not be subject to sales tax, but that admissions charges, cover charges, sales of tangible personal property (*i.e.*, club merchandise), and receipts from the sale of food and drink would be taxable. Consequently, Mr. Aslan formed Club VIP for the purpose of taking in the nontaxable exotic dancing receipts. He formed 20/20 for the purpose of receiving receipts from taxable admissions charges, cover charges and sales of club merchandise *(e.g.*, t-shirts, shot glasses, etc.), and he formed Prestige for the purpose of taking those receipts that included sales of food or drink. The auditor concedes that Club VIP, 20/20, and Prestige were set up, and are properly viewed, as separate and independent companies.

The VIP Club opened for business on February 19, 1996. At that time, Mr. Aslan and his management companies, along with Mr. Vargo, operated and controlled the club pursuant to a verbal arrangement that they had previously reached with Mr. Marchello. On August 15, 1996, this verbal arrangement was formalized in a written Operating Agreement, executed by Frank Marchello in his individual capacity, and as president of "A" Street and Dezer Entertainment, and Steve Aslan in his individual capacity, and as president of Club VIP, 20/20, and Prestige.

We modify finding of fact "11" of the Administrative Law Judge's determination to read as follows:

The August 15, 1996 Operating Agreement required that Mr. Aslan

manage the day-to-day operations of the VIP Club, including the collection and remittance of taxes. The Operating Agreement specifically provided:

> **DEC** hires **ASLAN** and **ASLAN** agrees to perform on behalf of **DEC**, all of the functions usual and customary to the management of the **CLUB**, and to pay out of the income of the Club all expenses in connection with the management of the **CLUB**, including without limitation, rent, repairs, insurance, utilities, maintenance of the Premises, employee withholding taxes, social security taxes, rent occupancy taxes, sales taxes, unemployment taxes, workmen's compensation taxes, and any and all other taxes, charges, fees expenses of whatever nature or kind incurred in the conduct of or in the operation of the **CLUB**. Should **ASLAN** not pay these items from the income of the **CLUB**, **ASLAN** hereby indemnifies and holds harmless **MARCHELLO**, **DEC**, and **ASEC** from any of the foregoing taxes and expenses.

> The agreement also required Mr. Aslan to pay to Mr. Marchello the sum of $2,884.62 per week until Mr. Marchello was paid the sum of $750,000.00. The agreement further required that any profits, after the payment of all expenses (including Mr. Aslan's) and fees incurred in the management of the club, be paid to Mr. Marchello. The terms of the agreement also required Mr. Aslan to make himself available to Mr. Marchello for meetings and consultations, to provide copies of the quarterly sales tax returns to petitioner, and to make the club's books and records available to Mr. Marchello for his review upon request. The term of the operating agreement was five years.[6]

We modify finding of fact "12" of the Administrative Law Judge's determination to read as follows:

> Mr. Aslan testified that Mr. Marchello received payments towards the recoupment of his $750,000.00 investment and, at times, received additional amounts that Mr. Aslan and Mr. Vargo paid him. Mr. Aslan testified that he and Mr. Vargo made these additional payments to Mr. Marchello because they thought it would help maintain a positive relationship with Mr. Marchello. Mr. Alsan testified that this was important to him and Mr. Vargo because they were interested in buying the club from Mr. Marchello and they felt that making these additional payments might position them more favorably as prospective buyers. Mr. Aslan also testified that he would write checks to Mr. Marchello that would bounce. Other than these additional payments, Mr. Aslan and Mr. Vargo kept the

[6] We modify this fact to more completely reflect the record.

profits from the club.[7]

We modify finding of fact "13" of the Administrative Law Judge's determination to read as follows:

> The record does not contain articles of incorporation, minutes of meetings, or other corporate documentation from Prestige, 20/20, or Club VIP. However, tax returns for the years 1997 and 1998 were submitted into evidence and indicate that Mr. Aslan owned 100 percent of Club VIP. At the hearing, Mr. Aslan testified that he was the sole owner, shareholder, director, and officer of the aforementioned companies.
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> Through his management companies, Mr. Aslan managed and operated the VIP Club. Mr. Aslan acknowledged that Mr. Marchello had authority to dictate the daily affairs of the club. When the club first opened, Mr. Aslan met with Mr. Marchello regularly to discuss the operation of the club. At those meetings, Mr. Marchello offered suggestions about actions that needed to be taken on behalf of the club. Mr. Marchello was satisfied with the direction of the club and trusted Mr. Aslan's management. Over time, Mr. Marchello's meetings with Mr. Aslan became less frequent. During the last year of Mr. Marchello's life, he rarely met with Mr. Aslan. Although Mr. Marchello had full access to the club's books and records, he never asked Mr. Aslan to review those books and records.[8]

During the audit period, the VIP Club derived approximately two-thirds of its revenue from the sale of "dance dollars." The dance dollars were scrip (i.e., "funny money") that the club's customers could purchase and then use to purchase exotic dances, or to tip the dancers and wait staff. Customers who purchased dance dollars would be charged a surcharge, which was used to help cover expenses incurred by the club in connection with the dance dollars (e.g., costs associated with printing the dance dollars). Approximately 99 percent of the club's customers purchased dance dollars with credit cards. The charges for these transactions were invoiced and

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[7] We modify this fact to more accurately reflect the record.

[8] We modify this fact to more completely reflect the record.

received by Club VIP, which did not charge sales tax on the purchase of dance dollars. Employees of Prestige (and later 20/20) sold the dance dollars to the club's customers.

The dancers who performed at the VIP Club did so as independent contractors. The dancers were not paid a salary and were responsible for soliciting dances from the club's patrons. They were also required to pay a "house fee" to Club VIP for each night that they performed at the club. The house fee was essentially a license fee incurred by the dancers for the right to use the club's facility. The dancers could pay the house fee with cash, but in most cases they did so with dance dollars that they earned from the club's patrons. The dancers would also pay a 10 percent handling fee to Club VIP for the use of its merchant accounts, which allowed them to get paid in dance dollars if a customer did not have cash on hand. The dancers kept the remainder of the dance dollars that they earned. At the end of the evening, the dancers would turn in the dance dollars and receive cash or a check for 90 percent of the face value of the turned-in dance dollars. The club's customers also purchased exotic dances with cash.

Any exotic dances that were purchased by customers of the VIP Club took place within the confines of the club. The VIP Club consisted of about 8,000 square feet and had one large main floor with a long bar on one side. There was also a mezzanine level that wrapped around a portion of the club. A second bar and tables were located on the mezzanine. From each end of the mezzanine, two stairwells led to the club's top balcony. When the VIP Club first opened, there was one VIP room on the balcony where customers could purchase private dances. Additional VIP rooms were added to the balcony and certain areas of the club's main floor during the audit period. Customers could purchase dances to be performed both inside a private VIP room, as well as out "in the open," i.e., at locations within the club, but outside of the private

VIP rooms.

Customers of the VIP Club were never required to purchase food or beverages in connection with a dance that was purchased for performance outside of a private room. When customers purchased a dance to be performed "in the open," all that the customer purchased was the dance. Club VIP did not charge sales tax on these "dance only" transactions.

When customers wanted to purchase a private dance to be performed in a VIP room, they were not charged an admission fee to the room. They were, however, charged a fee for a bottle of champagne or if the customer did not drink champagne, a couple rounds of drinks. The patron was charged for the champagne at the same price they would have paid had they ordered it at the bar. Once inside the private room, the customer transacted separately and directly with the dancer for the fee to be paid for the dance. Thus, the charges for the champagne (or other drinks) and the dance were separately invoiced. Prestige, the entity set up to take in the club's food and beverage revenue, would charge the customer for the champagne and would charge sales tax on the transaction. Club VIP, on the other hand, would charge the customers for the dance dollars that were used to pay the dancer in the private room. Club VIP did not charge sales tax on these private room, "dance only" transactions.

Club VIP did not invoice or receive any revenue from patrons of the club other than the dance dollars that were used to purchase exotic dances. Club VIP did not charge sales tax on any of its sales. All of the club's other charges were, however, treated as being subject to sales tax during the audit period. 20/20 invoiced and collected the club's admissions charges, cover charges and charges for club merchandise, and charged sales tax on all such transactions. As previously indicated, Prestige invoiced and charged sales tax on all receipts collected for food

and beverage. After Prestige filed for bankruptcy in 1999 and stopped operating in 2000, such charges were invoiced and collected by 20/20, which also charged sales tax on the food and beverage transactions.

As noted above, the Operating Agreement required Mr. Aslan and his management companies to pay all the expenses associated with the day-to-day operations of the club, including the rent for the premises. Prestige claimed a rental deduction of $187,095.00, $370,593.00 and $555,434.00, respectively, on its federal income tax returns for the years 1996, 1997 and 1998, respectively. 20/20 claimed a rental deduction of $111,807.00, $56,975.00 and $0.00, respectively, on its federal income tax returns for the years 1996, 1997 and 1998, respectively. Club VIP claimed a rental deduction of $159,325.00, $96,267.00 and $126,300.00, respectively, on its federal income tax returns for the years 1996, 1997 and 1998, respectively.

We modify finding of fact "21" of the Administrative Law Judge's determination to read as follows:

> On March 30, 2007, Salvatore (a/k/a "Uncle Sal," a/k/a "Fat Sal") Scala and Thomas (a/k/a "Monk") Sassano were convicted in the United States District Court for the Southern District of New York on charges connected to their extortion of the VIP Club from the mid-1990s through 2002. Specifically, Messrs. Scala and Sassano were convicted of knowingly committing extortion as that term is defined in 18 USC § 1951(b)(2), by attaining money and property from and with the consent of the owner and operators of the VIP Club, which consent was induced by the wrongful use of actual and threatened force, violence, and fear, and thereby did obstruct, delay and affect commerce, and the movement of articles and commodities in commerce as that term is defined in 18 USC § 1951(b)(3). Petitioners submitted the transcript of this trial into the record.
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> In an April 6, 2007 press release, the United States Attorney's Office for the Southern District of New York characterized their conduct as having "bled the club dry." Messrs. Scala and Sassano demanded regular payments from the VIP Club that ranged from $2,500.00 to over $15,000.00 every two weeks and had to be paid in order to "keep the peace." At the hearing, Mr. Aslan testified that he

believed that if the payments were not made, there would have been "serious, violent repercussions" (***see*** Federal Transcript, Exhibit 20 at Vol. 4, p. 543). Mr. Aslan felt intimidated by Messrs. Scala and Sassano and generally "feared for [his] health" (***see*** Federal Transcript, Exhibit 20 at Vol. 4, p. 543). Mr. Aslan feared physical violence and the possibility of being "beaten up" by them (***see*** Federal Transcript, Exhibit 20 at Vol. 4, p. 543).[9]

We modify finding of fact "22" of the Administrative Law Judge's determination to read as follows:

> Mr. Aslan first learned that the VIP Club was being extorted by the mob when, a few weeks after opening the club, Mr. Vargo told him that they would have to start making protection payments to Mr. Scala. Mr. Vargo had been told, in the course of the negotiations to take over the club, that the payments would have to be made, but he did not tell Mr. Aslan at the time. Indeed, Mr. Aslan testified that during the negotiations, Mr. Scala held himself out as Mr. Marchello's "representative."[10]

We modify finding of fact "23" of the Administrative Law Judge's determination to read as follows:

> Mr. Aslan testified that Messrs. Scala and Sassano "forced" the club to keep, on average, between five and seven mob associates on the payroll. This took place during the entire audit period. The individuals were ostensibly employed as "security," but, Mr. Aslan claimed that, in reality, they did not perform any services for the club whatsoever. Mr. Aslan testified that Mr. Scala wanted these mob associates to be at the club to act as his "eyes and ears" when he could not be present. Although Mr. Scala was arrested for an unrelated crime in June 2000 and was convicted of such crime in 2001, Mr. Sassano continued to collect payments on Mr. Scala's behalf from the club through 2002.[11]

We modify finding of fact "24" of the Administrative Law Judge's determination to read as follows:

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[9] We modify this fact to more accurately reflect the record.

[10] We modify this fact to more accurately reflect the record by removing elements that are unsupported by the record. We particularly note that the transcript from the criminal trial of Messrs. Scala and Sassano suggests that petitioner, Mr. Marchello, was investigated by the FBI for his involvement with organized crime.

[11] We modify this fact to more accurately reflect the record.

> Mr. Aslan testified that the individuals whom Mr. Scala had on the club's payroll could not be fired or removed from the club without Mr. Scala's permission. Indeed, most of these "employees" had been forced onto the payroll of Silverado when Mr. Marchello ran the club. Mr. Scala required them to be kept on as "holdovers" once Mr. Aslan and Mr. Vargo took over the club. Mr. Aslan claimed that he did not learn that the club was also going to have to pay these other mob associates until after he began operating the VIP Club.[12]

During the audit period, Mr. Scala's associates and friends were also permitted (on Mr. Scala's orders) to run up tabs for food and drink at the VIP Club. These tabs, which were never paid, varied in amount from a couple thousand dollars to, at times, over $8,000.00. In total, the VIP Club lost tens of thousands of dollars in unpaid food and beverage tabs during the audit period.

We modify finding of fact "26" of the Administrative Law Judge's determination to read as follows:

> Mr. Alsan also testified that the VIP Club was forced to make payments to the the Genovese crime family in the amount of roughly $5,000.00 per week. These payments began shortly after Mr. Scala began to demand his protection payments and lasted until Mr. Vargo left the club around July 2002. Mr. Aslan claimed that Mr. Vargo collected the payments on behalf of the Genovese crime family.[13]

We modify finding of fact "27" of the Administrative Law Judge's determination to read as follows:

> Mr. Vargo was a friend of Mr. Aslan. Mr. Vargo helped introduce Mr. Aslan to the gentlemen's club business. Prior to entering into his agreement with petitioner, Mr. Aslan and Mr. Vargo were involved in and successful at managing other gentlemen's clubs together. Mr. Aslan testified that Mr. Vargo knew the business better and that he relied upon Mr. Vargo for information. Mr. Aslan

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[12] We modify this fact to more accurately reflect the record.

[13] We modify this fact to more accurately reflect the record by removing elements that are unsupported by the record.

implied that Mr. Vargo would have been involved in the VIP Club management corporations but for the judgments against Mr. Vargo. However, Mr. Aslan always considered Mr. Vargo a partner.

Mr. Vargo developed a serious drug and gambling problem. Mr. Alsan stated that while Mr. Vargo's drug use "was not really a problem as far as payments of the money for them," the gambling problem resulted in Mr. Vargo becoming indebted to a host of bookies who were connected to a variety of organized crime families.

Mr. Vargo's gambling problem escalated about one year after he and Mr. Aslan took over the club and reached a peak toward the middle of 2002. The VIP Club made weekly payments to Mr. Vargo's bookies. These payments averaged between $5,000.00 and $10,000.00, but at times approached $20,000.00. Over the course of the audit period, the VIP Club was forced to pay in excess of $1 million to Mr. Vargo's bookies. It is unclear whether these amounts were taken outright by Mr. Vargo, or if Mr. Alsan sanctioned the payments of Mr. Vargo's debts to help his friend.

Mr. Aslan stated that, over time, his relationship with Mr. Vargo degenerated, due in part to Mr. Vargo's debts. Over the course of six and a half years, Mr. Aslan had approximately four or five physical altercations with Mr. Vargo. Although Mr. Aslan was never beaten up, he and Mr. Vargo did get into a heavy shoving match and Mr. Vargo once attempted to punch him.

In addition, the activities of Mr. Aslan himself strained the financial health of the club. At the federal trial, he testified under oath that he used receipts from the club to pay his rent, pay for his car, and start up two other business in New York City. He also used club funds to go to the Super Bowl three times, to rent a summer house in Atlantic City, New Jersey and to repay a loan from his parents.[14]

We modify finding of fact "28" of the Administrative Law Judge's determination to read as follows:

The activities of Messrs. Aslan, Vargo, Scala, and Sassano crippled the financial well-being of the VIP Club. Over the course of the audit period, the VIP Club was forced to pay out close to $4 million dollars in payments to these individuals. The resulting financial impact created a "major cash flow problem." The VIP Club regularly bounced checks that were issued to its employees and vendors. Many of the checks that were sent to Mr. Marchello to repay him for his

[14] We modify this fact to more accurately reflect the record.

investment in the club also bounced. Rather than alter their business model to satisfy the club's debts before paying others, including the foregoing, the club managers made it a habit to pass bad checks and pay only those vendors that were necessary to keep its basic operations going, such as utilities and food and beverage vendors.[15]

We modify finding of fact "29" of the Administrative Law Judge's determination to read as follows:

> At the hearing before the Division of Tax Appeals, Mr. Aslan testified that the financial burdens placed on the VIP Club, *i.e.*, the management companies, made it impossible for the club to satisfy its federal and New York State obligations. 20/20 and Prestige frequently filed late sales tax returns with New York, and were often unable to remit the sales tax that was shown as owing on the returns.
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> Mr. Aslan testified that he made every effort to meet these sales tax obligations because he knew that he would be held personally liable for the taxes if they were not paid. Both 20/20 and Prestige entered into payment plans with New York to pay the back taxes due. These back taxes were, however, never fully paid.[16]

We modify finding of fact "30" of the Administrative Law Judge's determination to read as follows:

> At the hearing, Mr. Aslan testified that the activities of Messrs. Scala, Sassano and Vargo would have prohibited Club VIP from meeting its sales tax obligations, even if a determination had been made that its dance dollars were subject to sales tax.[17]

We modify finding of fact "31" of the Administrative Law Judge's determination to read as follows:

> After a four-year battle with lung cancer, Mr. Marchello passed away at his home in Ringoes, New Jersey, on January 29, 2002. Initially, Camille

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[15] We modify this fact to more accurately reflect the record.

[16] We modify this fact to more accurately reflect the record.

[17] We modify this fact to more accurately reflect the record.

> Landano was appointed executrix of Mr. Marchello's estate but she was removed because she was disrespectful to Mrs. Marchello and her family. After Ms. Landano was removed, John Manfreda served as executor of the estate for a short period of time. Mr. Marchello's childhood and lifelong friend, William Fleming, was appointed executor of his estate on July 12, 2002.[18]

We modify finding of fact "32" of the Administrative Law Judge's determination to read as follows:

> Following Mr. Marchello's death, the task of marshaling and selling the assets of the estate began. With respect to the club assets, the estate hired Alan M. Kapson, Mr. Marchello's New York attorney since 1993, as its representative. Mr. Kapson advised the estate that it could "evict" the current tenants of the club because the August 15, 1996 Operating Agreement had expired. Consequently, Mr. Aslan and his management companies no longer had a contractual right to continue running the VIP Club using the assets and lease owned by Dezer Entertainment. Mr. Fleming, as executor, authorized Mr. Kapson to take control of the day-to-day operations of the club on behalf of Mr. Marchello's estate, until the club assets could be sold. Mr. Fleming never saw any indication of a mob presence at the VIP Club. However, Mr. Fleming quickly learned from Mr. Kapson that the club was suffering significant financial strain because of the waste and financial mismanagement of the club. Mr. Kapson advised him that the club was insolvent and might not be able to pay its bills, including taxes.[19]

We modify finding of fact "33" of the Administrative Law Judge's determination to read as follows:

> At the hearing, Mr. Fleming credibly testified that associates of Mr. Scala called, threatened him, and told him that he was not allowed to assign the lease for the premises or sell the assets to anyone but either Mr. Scala or Mr. Sassano. As a result, Mr. Fleming was afraid to deal with the sale of the club.
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> The record also shows that, in late July 2002, Mr. Kapson and Mr. Sassano had an incident wherein Mr. Sassano yelled in Mr. Kapson's face and Mr. Kapson pushed Mr. Sassano. After this brief conversation, Mr. Kapson resigned as the estate's representative that same night.[20]

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[18] We modify this fact to more accurately reflect the record by removing unsupported elements.

[19] We modify this fact to more accurately reflect the record.

[20] We modify this fact to more accurately reflect the record.

We modify finding of fact "34" of the Administrative Law Judge's determination to read as follows:

> Ultimately, a sale of the club was negotiated. This took place on August 26, 2002 when Dezer Entertainment entered into an Assignment and Assumption of Lease, along with an Agreement of Purchase and Sale of Assets. On behalf of Dezer Entertainment, Mr. Fleming, as executor of the estate of Frank Marchello, executed both the assignment and the agreement. Review of the purchase and sale agreement indicates a sale price of $1,505,461.42 for the club.[21]

Dezer Entertainment Concepts, Inc.'s name was changed to Hillsborough Corp. (Hillsborough) on December 6, 2002, by Certificate of Amendment of the Certificate of Incorporation of Dezer Entertainment Concepts, Inc., under section 805 of the Business Corporation Law.

As noted above, Mr. Aslan had set up three companies to manage the day-to-day operations of the VIP Club. Two of the corporations, 20/20 and Prestige were registered sales tax vendors that filed sales tax returns but did not pay the proper amount of tax due on such returns. The third, Club VIP was not a registered vendor and did not file any sales tax returns for the period December 1, 1995 through August 31, 2002.

The Division began a sales and use tax field audit of 20/20 on May 1, 2002. An auditor, Nathan Finkelshteyn, and his team leader, Michael Macaluso, conducted a field audit appointment of 20/20 at the club premises on July 18, 2002. As a result of information supplied by Mr. Aslan at that field audit appointment, the sales and use tax audit of 20/20 was transferred to Alton Plunkett, the auditor assigned by the Division to conduct the sales and use tax field audit of Prestige and Club VIP.

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[21] We modify this fact to more accurately reflect the record.

On August 15, 2002, while beginning his field audit of Prestige and 20/20, Mr. Plunkett delivered a handwritten request for the books and records of Club VIP to Mr. Aslan, requesting the books and records for the period December 1, 1995 through May 31, 2002. On August 16, 2002, Mr. Plunkett mailed an appointment letter to Club VIP scheduling a field audit appointment for August 23, 2002.

On August 21, 2002, Mr. Plunkett called Mr. Aslan to confirm the August 23, 2002 appointment but was unable to reach him. The auditor left a message asking Mr. Aslan to return his call. On September 18, 2002, the auditor again attempted to contact Mr. Aslan by telephone to schedule an audit appointment but was unable to reach him. The individual who answered the telephone at the club advised Mr. Plunkett that Mr. Aslan no longer worked there and that the business was under new management. That person provided Mr. Plunkett with a telephone number for Mr. Aslan. Subsequently, on September 23, 2002, Mr. Plunkett was able to reach Mr. Aslan at the new telephone number. During that conversation, Mr. Aslan confirmed that the club was in fact sold but stated that he was not involved in the sale. Mr. Aslan also requested additional time to make the books and records of Club VIP available for audit.

On November 15, 2002, the auditor received a letter from Mr. Aslan, stating, among other things, that the VIP Club was owned by Dezer Entertainment, which company held both the lease for the premises and the liquor license. The letter further stated that Mr. Marchello had died on January 29, 2002, that ownership of Dezer Entertainment and thereby the club was passed on to Mr. Marchello's wife, Annabelle, and that Mr. Bill Fleming was named the executor of Mr. Marchello's estate. In this letter, Mr. Aslan also stated that, on August 26, 2002, Mr. Marchello's executor informed him that the club was sold and that he should turn over its

operation to the new owners, Anthony Capeci and his associates. Mr. Aslan further stated in his letter that he found out that West 20th Enterprises Corp., was the new corporate entity operating the club.

After receiving the November 15, 2002 letter, the Division's auditor did not make any attempt to contact Mr. Fleming. Even though he was in contact with Mr. Aslan at the time, he did not ask Mr. Aslan for Mr. Fleming's contact information, such as a phone number (which Mr. Aslan had available). The auditor also did not try to locate Mr. Fleming through the phone book or other means. Based upon the November 15, 2002 letter, the auditor assumed that Mr. Aslan worked for Mr. Fleming and would tell him about the sales tax audit of Club VIP. The auditor did not accept the November 15th letter as adequate evidence of Mr. Marchello's death or Mr. Fleming's appointment as executor of Mr. Marchello's estate. However, the auditor never requested or obtained copies of Mr. Marchello's death certificate, his last will and testament, the letters testamentary for his estate, or the estate tax return that was filed by his estate.

The auditor sent Club VIP a letter, dated March 19, 2003, in which he advised the corporation that all books and records pertaining to the sales and use tax liability for the period December 1, 1995 through August 31, 2002 should be available at the appointment scheduled for April 9, 2003 at Club VIP's offices. A Records Requested List was attached to the letter.

An entry for April 9, 2003 in Club VIP's Tax Field Audit Record (audit record) indicates that at a Metropolitan District Office conference (office conference), Mr. Aslan provided the auditor and his team leader, Mr. Macaluso, with copies of Club VIP's federal income tax returns for the years 1996, 1997 and 1998. During that office conference, Mr. Aslan requested additional time to provide the remainder of the corporation's books and records. An audit record

entry for October 9, 2003 indicates that, during a telephone call initiated by the auditor, Mr. Aslan again requested additional time to provide the corporation's books and records.

Because no other books and records for Club VIP were provided, the auditor used the corporation's federal income tax returns for the years 1996, 1997 and 1998 to determine its sales and use tax liability for the period in issue.

For the period February 1996 through December 1996, Club VIP reported $3,761,543.00 in gross sales on its 1996 federal income tax return. The corporation reported gross sales of $8,295,273.00 and $6,892,465.00, respectively, for the years 1997 and 1998, respectively, on the federal income tax returns filed for such years. Because there was no information provided for the remainder of the audit period, the auditor computed average annual gross sales for the years 1997 and 1998 of $7,593,869.00 and determined that this amount was the gross sales for each of the years 1999, 2000 and 2001. For the months of January through August 2002, the auditor prorated the average annual gross sales and determined that sales for the eight-month period were $5,062,579.00. He then added the gross sales reported for the years 1996 through 1998 and the gross sales calculated for the remainder of the audit period, and determined total gross sales of $46,793,467.00 for the period December 1, 1995 through August 31, 2002. As no evidence was provided that any sales were exempt, the auditor deemed all receipts taxable. After multiplying taxable sales of $46,793,467.00 by the applicable tax rate, the auditor determined tax due from sales in the amount of $3,860,461.11 for the period in issue.

The auditor also used available information from the corporation's federal income tax returns for the years 1996, 1997 and 1998 to determine use tax due on expense purchases. As with sales, the returns provided expense information for the period February 1996 through

December 1998. The auditor reviewed these expense purchases and selected taxable expense items including professional and consulting fees, office supplies, janitorial, equipment rental, and bath and dressing room supplies, and determined taxable expenses of $297,141.00, $1,187,359.00 and $885,935.00, respectively, for the years 1996, 1997 and 1998. The auditor computed average taxable expense purchases for the years 1997 and 1998 of $1,036,647.00, and projected that average for taxable expense purchases for each of the years 1999 through 2001. Just as was done for sales, the auditor prorated average taxable expense purchases for the months of January through August 2002 and determined taxable expense purchases for the eight-month period of $691,098.00. Because Club VIP provided no proof that it paid tax on its taxable expense purchases for the period at issue, the auditor determined that use tax was due on these expense purchases. Accordingly, the auditor determined total taxable expense purchases of $6,171,474.00 for the period December 1, 1995 through August 31, 2002, and after applying the applicable tax rate to such taxable expenses, determined use tax due in the amount of $509,146.58 on expense purchases for the period in issue.

The auditor combined $3,860,461.11, the tax due on additional taxable sales of $46,793,467.00, with $509,146.58, the use tax due on expense purchases of $6,171,474.00, and determined total sales and use tax due on audit of $4,369,607.69. These amounts were reflected in a Statement of Proposed Audit Change for Sales and Use Tax, which was issued to Club VIP in April 2004. The Statement of Proposed Audit Change also asserted interest due, along with penalties in the amount of $1,309,099.33. The auditor assessed "regular penalties" because "penalty is normally assessed on these cases."

The audit conclusions and copies of the audit work papers were provided to Mr. Aslan on

April 14, 2004 at an office conference. During that meeting, Mr. Aslan requested additional time to review the audit work papers and to obtain additional records. Review of the audit record indicates that no additional records were provided.

During the course of the Division's audit of Club VIP, the United States government seized the VIP Club's books and records in connection with its investigation and prosecution of Messrs. Scala and Sassano. These books and records remain in the custody of the federal government.

Subsequently, the Division issued to Club VIP a Notice of Determination, Notice Number L024422061, assessing additional tax in the amount of $4,369,607.69, plus penalties and interest, for the period December 1, 1995 through August 31, 2002. The record does not include a copy of the Notice of Determination issued to Club VIP. The record also does not disclose whether Club VIP protested the Notice of Determination against it.

A review of the audit work papers indicates that the auditor concluded his audit of Club VIP on August 23, 2004, after spending a total of 62 hours on the audit of the corporation. At that time, the auditor made a determination that Steve Aslan and Hillsborough Corp. should be issued notices of determination on the grounds that they were liable as responsible persons for the additional taxes, interest and penalties that were asserted against Club VIP. Responsible officer assessments were not issued to Mr. Marchello or his estate at the time the auditor closed his audit of Club VIP.

At the hearing, the auditor conceded that he did not, at any time during the course of his audit, ever request a responsible person questionnaire for Club VIP. Nor did he request or receive any other information that showed: (i) that Mr. Marchello was a shareholder, employee,

officer, or director of Club VIP; (ii) that Mr. Marchello had the authority to sign, or ever actually signed, checks on behalf of the company; (iii) that Mr. Marchello signed any consents to extend the statute of limitations for asserting additional sales or use tax against the company; (iv) that Mr. Marchello had the authority to hire and fire employees or that he ever actually hired or fired an employee; (v) that Mr. Marchello had the authority to direct, or ever actually directed, the company as to the payment of its creditors; or (vi) that Mr. Marchello had the authority to negotiate, or ever actually negotiated, loans on behalf of the company. The auditor also conceded that he never spoke with the executor of Mr. Marchello's estate, William Fleming, or his widow, Annabelle, regarding Mr. Marchello's involvement, if any, in the company.

We modify finding of fact "53" of the Administrative Law Judge's determination to read as follows:

> As noted above, on February 10, 2005, the Division issued a Notice of Determination (L-025022670) to Frank A. Marchello, which asserted that he was liable, as a responsible person, for the additional sales and use taxes, interest and penalties that had been asserted against Club VIP. At the hearing, the auditor explained that he based his determination that Mr. Marchello was a responsible person on a conference between himself, his supervisor, and Mr. Aslan. Therein, Mr. Aslan told the auditor that he was taking orders and was not the only responsible person. He presented the Division with a copy of the Operating Agreement between himself and Mr. Marchello. Based upon his review of the document, the auditor determined Mr. Marchello to be a responsible person.[22]

At some point during the audit of Club VIP, the auditor received a copy of the Operating Agreement. However, he made no notation of receipt of this document in his audit record because, at the time, he did not think it was an important document.

The Notice of Determination was issued and addressed to Mr. Marchello at PO Box 189,

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[22] We modify this fact to more accurately reflect the record.

Basking Ridge, New Jersey. The PO Box 189 had been used by Mr. Marchello in connection with his businesses. Mr. Fleming, the estate's executor, conceded that he received the Notice of Determination issued to Mr. Marchello. At the time the Notice of Determination was issued to Mr. Marchello, Mr. Fleming's address was Toms River, New Jersey. After he became executor of Mr. Marchello's estate, Mr. Fleming never initiated any contact with the Division before receiving the Notice of Determination issued to Mr. Marchello because he had no idea there was a tax issue. Subsequently, that Notice of Determination was protested at a Bureau of Conciliation and Mediation Services conference. By Conciliation Order dated September 8, 2006, the conferee sustained the statutory notice.

On December 4, 2006, petitioner timely filed the petition in this matter. On February 21, 2007, the Division issued an answer to the petition. The Division's answer affirmatively states that Mr. Marchello was being deemed a responsible person of Club VIP. The answer did not notify petitioner that the Division would seek to hold him liable as a responsible person of Hillsborough.

We modify finding of fact "57" of the Administrative Law Judge's determination to read as follows:

> During the hearing in this matter, the Division's auditor was asked to provide testimony regarding the taxability of exotic dance transactions, such as those that Club VIP had entered into during the audit period. The Division's auditor testified that, in his 25 years as an auditor, he has conducted "quite a few" audits of establishments similar to the VIP Club. The auditor stated that each audit differs depending upon the facts. On the issue of taxability, the auditor testified that the determination of taxability depends upon the books and records presented by the taxpayer. Herein, the auditor relied on information provided by Mr. Aslan because the auditor was not provided with source documentation of the subject sales. The audit record entry for February 11, 2003 indicates that the auditor "reviewed case and case folders of similar audits," and spent a total of five

hours on such review.[23]

The auditor ultimately provided testimony regarding his determinations in prior audits as to the taxability of exotic dances. The auditor testified that the sale of an exotic dance would be subject to sales tax only if it was sold to the customer as part of a package that also included the sale of taxable food or drink. The auditor testified that the sale of a dance alone would not be taxable. Moreover, the auditor testified that it does not matter whether the dance is performed out in the open of the club or in a private room. The auditor also noted that a separate fee charged for access to a private room would be subject to sales tax as an admission charge. The auditor emphasized, however, that the sale of a dance to be performed within the private room remains nontaxable even if a separate admission fee is charged.

The record includes Mr. Plunkett's audit work papers for 20/20 and Prestige. A review of 20/20's audit work papers indicates that Mr. Plunkett described the nature of its business as a "restaurant and bar with entertainment," and after charging 57½ hours to the audit, determined additional tax due in the amount of $140,459.73, plus interest and penalties for the period December 1, 1995 through August 31, 2002. A review of Prestige's audit work papers indicates that Mr. Plunkett described the nature of its business as a "restaurant and bar with entertainment," and after charging 79 hours to the audit, determined additional tax due in the amount of $1,244,054.18, plus interest and penalties for the period December 1, 1995 through November 30, 2000.

The record includes copies of the New York State Liquor Authority files for Dezer Entertainment, which the Division obtained in preparation for the hearing in this matter. A

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[23] We modify this fact to more accurately reflect the record.

review of these files indicates that Mr. Marchello submitted documents to the State Liquor Authority identifying himself as owner of the club and changing the club's trade name to the VIP Club. Further review of these files indicates that Mr. Marchello was the principal for the liquor license used by the VIP Club.

The issues addressed at the hearing may be generally summarized as follows: the audit of Club VIP and the taxability of its receipts; the Division's determination that Frank Marchello was a person responsible for collecting and paying over the sales taxes allegedly due from Club VIP; and the propriety of issuing the Notice of Determination to Frank Marchello, rather than to his estate. At the hearing, the Division did not raise the issue that Hillsborough was the vendor responsible for the collection of New York State taxes and that Frank Marchello, as president of Hillsborough, was a responsible person.

At the conclusion of the hearing, the record closed. Petitioner's brief was timely filed on March 27, 2008. The Division filed its brief on July 8, 2008. In that brief, the Division argued, among other things, that Hillsborough was the vendor responsible for the remission of sales taxes owed by Club VIP, and that petitioner was a responsible person of Hillsborough. By notice of motion, dated August 20, 2008, petitioner moved for an order reopening the record and admitting additional evidence, and granting summary determination in its favor. In its motion to reopen the record, petitioner contended that the record should be reopened for the admission of additional evidence necessary for it to fully and adequately respond to the new legal theory raised in the Division's brief. Specifically, petitioner requested that the following documents be admitted into evidence: (i) a copy of an Audit Verification Letter issued on July 3, 2008 by the sales tax section of the Division's Metropolitan District Office to Hillsborough for the period December 1, 1995

through August 31, 2002 (Audit Verification Letter); and (ii) a copy of a No Change Letter issued on July 3, 2008 by the sales tax section of the Division's Metropolitan District Office to Hillsborough for the period December 1, 1995 through August 31, 2002 (No Change Letter). The Division did not file a response to petitioner's motion to reopen the record and admit additional documents.

By order dated January 29, 2009, petitioner's motion for summary determination was denied as having been filed beyond the time allowed in CPLR 3212(a). Petitioner's motion to reopen the record was, however, granted. As a result, both the Audit Verification Letter and the No Change Letter were admitted into evidence. The Audit Verification Letter confirms that the Division conducted and completed a sales and use tax audit of Hillsborough for the periods at issue in this proceeding. The No Change Letter states, among other things: "We have completed our tax audit for the period(s) listed above and have concluded that no additional tax is due." Except for the Audit Verification Letter and the No Change Letter, no other evidence was permitted into the record. Following the January 29, 2009 order, the record again was closed.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge rejected petitioner's jurisdictional argument as baseless because the Division was not provided with any notice either validating the appointment of Mr. Fleming as executor (e.g., an order of appointment) or providing an address for Mr. Fleming.

The Administrative Law Judge determined that there was an underlying corporate liability because the record established that a Notice of Determination was issued to Club VIP and such notice was unchallenged by petitioner.

The Administrative Law Judge found that the Division had a rational basis to assess Mr.

Marchello for the period December 1, 1995 through January 29, 2002, because the auditor testified that he determined that Mr. Marchello was a responsible person based upon his review of the 1996 Operating Agreement entered into by Mr. Marchello and Mr. Aslan. However, the Administrative Law Judge determined that no rational basis existed for the period January 30, 2002 through August 31, 2002, because petitioner had expired and, therefore, the agency relationship was terminated.

The Administrative Law Judge ultimately held that Mr. Marchello could not be held as a responsible individual because the influences of Mr. Vargo and the mafia thwarted the ability of Mr. Aslan, petitioner's agent, to operate the club. Accordingly, the Administrative Law Judge cancelled the subject Notices of Determination. This conclusion of the Administrative Law Judge rendered the remaining issues moot.

ARGUMENTS ON EXCEPTION

On exception, the Division seeks reversal on that ground that the Administrative Law Judge erred in concluding that petitioner was not responsible for the collection of sales tax for Club VIP. The Division argues that the receipts from the club were taxable and that it properly determined petitioner's tax liability. The Division argues that petitioner did not introduce clear and convincing evidence that Mr. Marchello was actually thwarted from acting on behalf of Club VIP. It is the Division's position that the determination of the Administrative Law Judge should be reversed on these grounds and that its imposition of penalties should be sustained.

Petitioner takes exception to the determination insofar as the Administrative Law Judge found proper jurisdiction and underlying corporate liability. Petitioner defends the conclusion that Mr. Marchello was not a responsible person by incorporating the reasoning of the

Administrative Law Judge into those arguments that petitioner raised below.

OPINION

Sales tax is imposed upon the receipts of every retail sale of tangible personal property in New York State (***see*** Tax Law § 1105[a]). Tax Law § 1101(b)(5) defines a "sale, selling or purchase" as:

> Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume . . . .

Petitioner owned the club at 20 West 20th Street and, on August 15, 1996, contracted with Mr. Aslan to manage the club. Mr. Aslan elected to utilize three different corporations, 20/20, Prestige, and Club VIP, to manage the different receipts of the club. The subject Notice of Determination concerns receipts from Club VIP. As petitioner's agent, this corporation managed primarily the sales of scrip, known as dance dollars, which patrons primarily used to procure dances, both in public and in private.

We address the issues on exception point by point.

First, we address the issue of whether the Notice of Determination is jurisdictionally defective because it was not issued to the estate of Frank Marchello. We affirm the conclusions of the Administrative Law Judge on this issue.

Tax Law § 1138(a)(1) states in pertinent part, that:

> A notice of determination shall be mailed by certified or registered mail to the person or persons liable for the collection or payment of the tax at his last known address in or out of this state. If such person or persons is deceased or under a legal disability, a notice of determination may be mailed to his last known address in or out of this state, unless the department has received notice of the existence of a fiduciary relationship with respect to the taxpayer.

We reject petitioner's argument that the notice should have been issued to Mr.

Marchello's estate, because the November 15, 2002 letter did not provide the Division with sufficient notice of a fiduciary relationship. This letter, which was sent to the Division by Mr. Aslan, was insufficient to provide the Division with the requisite notice because it did not provide any supporting proof of Mr. Marchello's passing (i.e. a death certificate), much less proof of Mr. Fleming's appointment as the executor for the estate (e.g. letter testamentary, letters of administration, or an order of appointment). A review of the audit log and the testimony of the auditor reveal that the Division was not provided with this documentation during the course of the audit. Further, the record does not contain any evidence that the estate filed any returns or other notices with the Division that would have put it on notice of Mr. Fleming's appointment and his fiduciary relationship with petitioner. Absent any official proof supporting the appointment, the Division had no basis to rely upon Mr. Aslan's letter, and is not deemed a proper notice under Tax Law § 1138 (a)(1). Accordingly, we hold that the Division properly issued the subject notice to Mr. Marchello at his last known address.

We also reject petitioner's argument that this forum lacks jurisdiction because the notice was issued to petitioner instead of his estate. It is not erroneous to issue a Notice of Determination in the name used by the taxpayer during the period of assessment (***see Matter of Orvis***, Tax Appeals Tribunal, January 14, 1993, ***confirmed*** 86 NY2d 165 [1995], ***cert denied*** 516 US 989 [1995]). At all times during the audit period, petitioner was named Frank A. Marchello. Accordingly, the Division was entitled to issue the Notice of Determination with petitioner's name, as opposed to his estate, and there was no error. Further, although the subject notice was issued to Mr. Marchello, it reached Mr. Fleming, who responded to the notice and filed the formal protest. Accordingly, there was neither harm nor prejudice that would warrant

invalidating the Notice of Determination (***see Matter of Orvis, supra***; ***Matter of Agosto v. Tax Commn.***, 68 NY2d 891 [1986]; ***Matter of A & J Parking Corp.***, Tax Appeals Tribunal, April 9, 1992).

Next, we address petitioner's argument that the Notice of Determination issued to Mr. Marchello should be cancelled because there is no underlying corporate assessment. We affirm the conclusions of the Administrative Law Judge on this issue.

Petitioner argues that the Notice of Determination issued to petitioner is, alone, insufficient to establish jurisdiction because the asserted deficiency is derived from the corporation's failure to pay sales tax amounts. Relying upon ***Matter of Mackiewicz*** (Tax Appeals Tribunal, June 7, 2007) and ***Matter of Scharff*** (Tax Appeals Tribunal, October 4, 1990), petitioner argues that the record must include the notice issued to Club VIP, in addition to the Notice of Determination issued to petitioner, for the Tax Appeals Tribunal to assert jurisdiction.

The Tax Appeals Tribunal is an adjudicative body of limited and statutorily created jurisdiction (***see*** Tax Law § 2008). Jurisdiction over a tax controversy flows from the submission of a petition with a statutory notice of a deficiency or determination, issued to a party from whom the Division seeks to collect (***see*** Tax Law §§ 2008 and 1138; ***see also Matter of Francis***, Tax Appeals Tribunal, June 18, 2009). Herein, the Division submitted the Notice of Determination issued to petitioner, Frank A. Marchello, into the record at the hearing. As the Division seeks to collect against a taxpayer to whom the notice was issued, the submitted notice is a valid statutory document that provides this forum with jurisdiction over the controversy.

We find that petitioner's argument that this Tribunal lacks jurisdiction is without merit. Petitioner does not challenge either that a notice was issued to Frank A. Marchello or that Club

VIP was issued a notice of determination. Rather, petitioner argues that the record in this case is jurisdictionally deficient without the Club VIP notice. Petitioner does not argue that the Division did not issue a notice of determination to Club VIP. Further, the record establishes that such notice was issued and received. There is no evidence that Club VIP challenged the Notice of Determination issued against it. As these facts were uncontroverted by petitioner, the Division was not required to prove the proper mailing of the Notice of Determination issued to Club VIP.

We further note that petitioner's reliance on ***Matter of Mackiewicz*** (***supra***) is misplaced. That case stands for the proposition that any adjustment to a corporate assessment must flow through to an assessment issued to a responsible individual because the individual liability is derived from the corporate assessment. There is no evidence that adjustments were made to the corporate assessment. As the circumstances herein substantially differ, ***Mackiewicz*** (***supra***) does not support petitioner's argument.

Next, we address the issue of whether the notice is supported by a rational basis. We agree with the determination of the Administrative Law Judge on this issue.

The record shows that the Division's decision to assess petitioner as a responsible person of Club VIP had a rational basis. The auditor testified that, during the course of the audit, he received the Operating Agreement that Mr. Marchello entered into with Mr. Aslan and his management companies (*i.e.*, 20/20, Prestige, and Club VIP). He further testified that his review of the Operating Agreement was the basis for his conclusion that Mr. Marchello was a responsible person for the collection and payment of sales tax for Club VIP.

The Operating Agreement was executed by Mr. Marchello in his individual capacity and as president of "A" Street and DEC, and by Mr. Aslan, in his individual capacity, and as

president of 20/20, Prestige, and Club VIP. The agreement required Mr. Aslan to manage the day-to-day operations of the club and to pay all expenses in connection with its management, including the collection and remittance of taxes due. The agreement also required Mr. Aslan to be available for meetings and consultations with Mr. Marchello, provide Mr. Marchello with copies of the quarterly sales tax returns, and make all books and records available to him upon request.

The terms of the Operating Agreement clearly show that Mr. Marchello and DEC employed Mr. Aslan and his management companies, 20/20, Prestige, and Club VIP, as his agents with respect to managing the club (***see e.g. L. Smirlock Realty Corp. v. Title Guar. Co.***, 70 AD2d 455 [1979] ***mod on other grounds*** 52 NY2d 179 [1981]).

It is a fundamental rule that a principal is bound by, and liable for, the acts of his agent conducted with or within the actual or apparent authority of the principal and within the scope of his employment (***see*** 3 NY Jur 2d, Agency § 239). This is no less true in the Tax Law (***see*** 20 NYCRR 526.10[a][3]; ***Matter of People's Oil Co.***, Tax Appeals Tribunal, December 8, 1988). Accordingly, the Division possessed a rational basis for determining that Mr. Marchello was personally liable for the sales tax obligations of Club VIP for the period December 1, 1995 through January 29, 2002. However, the Division had no rational basis for assessing Mr. Marchello for the period after his passing, i.e., January 30, 2002 through August 31, 2002, because the agency relationship terminated at that point, and as such, this portion of the Notice of Determination must be cancelled.

Addressing the issue of whether petitioner was a person responsible for the sales and use taxes due from Club VIP, we reverse the determination of the Administrative Law Judge.

Tax Law § 1133(a) imposes personal liability for taxes imposed by Article 28 of the Tax Law upon any individual required to collect such taxes. Tax Law § 1131(1) defines a "person required to collect any tax imposed by [Article 28]" as follows:

> [E]very vendor of tangible personal property or services; every recipient of amusement charges; and every operator of a hotel. Said terms shall also include any officer, director or employee of a corporation or of a dissolved corporation, any employee of a partnership, any employee or manager of a limited liability company, or any employee of an individual proprietorship who as such officer, director, employee or manager is under a duty to act for such corporation, partnership, limited liability company or individual proprietorship in complying with any requirement of this article; and any member of a partnership or limited liability company . . . .

The determination of whether an individual is a person under a duty to act for a corporation is based upon a close examination of the particular facts of the case (***see*** 20 NYCRR § 526.12[b][2]; ***Matter of Hall***, Tax Appeals Tribunal, March 22, 1990, ***confirmed*** 176 AD2d 1006 [1991]). As stated in ***Matter of Constantino*** (Tax Appeals Tribunal, September 27, 1990):

> [t]he question to be resolved in any particular case is whether the individual had or could have had sufficient authority and control over the affairs of the corporation to be considered a responsible officer or employee. The case law and the decisions of this Tribunal have identified a variety of factors as indicia of responsibility: the individual's status as an officer, director, or shareholder; authorization to write checks on behalf of the corporation; the individual's knowledge of and control over the financial affairs of the corporation; authorization to hire and fire employees; whether the individual signed tax returns for the corporation; the individual's economic interest in the corporation (citations omitted).

Our review of the record reveals that petitioner bore the indicia of responsibility for the taxes assessed against Club VIP for receipts generated at the VIP Club. Mr. Marchello owned the establishment known as the VIP Club. He freely hired Mr. Aslan and his management corporations, including Club VIP, to manage the establishment. Under the agreement,

petitioner's agents were responsible for all typical managerial responsibilities, as well as the collection and remittance of the subject taxes due. The agreement provided petitioner with the rights to any profits from the operation of the VIP Club and also required that he be paid a substantial weekly fee. The agreement further required that Mr. Aslan make himself available to meet and consult with petitioner regarding the management of the club, provide petitioner with copies of the quarterly sales tax returns, and make the books and records of the club available to petitioner, upon request. During the period of the agreement, petitioner did receive a portion of the profits, his weekly payments, and he asserted his rights to consult with his managers without incident. In fact, the record shows that Mr. Marchello was satisfied with their management of the club. Petitioner introduced no evidence tending to prove that Mr. Marchello was ever prevented or denied his rights under the Operating Agreement or the ability to control the affairs of the VIP Club (***see Matter of LaPenna***, Tax Appeals Tribunal, March 14, 1991; ***c.f. Chevlowe v. Koerner***, 95 Misc 2d 388 [1978]; ***Matter of Constantino***, ***supra***). As such, we find that petitioner is responsible for the collection and remittance of sales tax of Club VIP.

We conclude that the Division properly assessed petitioner, Mr. Marchello, as a responsible person for the sales tax liabilities of his agent, Club VIP. The 1996 Operating Agreement established a relationship between Mr. Marchello, the principal, and Club VIP, the agent. It is well-settled that a principal retains liability for the actions of his agent conducted with actual or apparent authority (***see*** 3 NY Jur 2d, Agency § 239; ***Morris v. Dept. of Taxation and Fin.***, 183 AD2d 5 [1992]; ***Hatton v. Quad Realty Corp.***, 100 AD2d 609 [1984] ***lv denied*** 63 NY2d 608 [1984]; ***see also Parlato v. Equitable Life Assur. Soc.***, 299 AD2d 108 [2002] ***lv denied*** 99 NY2d 508 [2003] [a principle who puts his agent in a position that enables such agent,

while acting with apparent authority, to defraud third parties is properly subject to liability for such fraud]). Herein, petitioner's agent failed to collect and remit trust funds rightfully belonging to the People of New York State. We perceive no difference between the conduct of Club VIP and other instances where principals have been liable for their agents acting with actual or apparent authority. As such, we hold that Mr. Marchello, as principal, is a person responsible for the subject taxes assessed against Club VIP, his agent.

Moreover, petitioner failed to carry his burden of proving that he was not a responsible person for Club VIP (***see e.g. Matter of Tavolacci v. State Tax Commn.***, 77 AD2d 759 [1980]). Petitioner did not submit documentation proving that he was not among the owners, officers and employees of the corporation (e.g. the articles of incorporation, corporate minutes or corporate returns for the years 1999 through 2002), but instead relies solely upon self-serving testimony. On balance, the documents in the record, and the testimony at hearing, evidence that petitioner had a financial interest in Club VIP, had the authority to review the books and records and, in fact, hired Mr. Aslan and his companies to manage the club. The record shows that petitioner had the authority to dictate and oversee the operations of the club, but elected not to exercise that authority (***see Matter of Blodnick v. State Tax Commn.***, 124 AD2d 437 [1986]; ***Matter of LaPenna***, ***supra***). Accordingly, we hold that petitioner failed to meet his burden of providing clear and convincing evidence that he was not a responsible person for Club VIP.

We have found exceptions to liability where a responsible person proved that he was precluded from acting on behalf of the corporation by the acts of another (***see Matter of Moschetto***, Tax Appeals Tribunal, March 17, 1994; ***Matter of Turiansky***, Tax Appeals Tribunal, January 20, 1994). In order to prevail on such a defense, petitioner is required:

> to establish by clear and convincing evidence that he was not an officer having a duty to act on behalf of the corporation, i.e., that he lacked the necessary authority or he had the necessary authority, but he was thwarted by others in carrying out his corporate duties through no fault of his own (citations omitted) (***Matter of Goodfriend***, Tax Appeals Tribunal, January 15, 1998).

This exception is only available where a responsible person did not have or could not have exercised sufficient authority and control over corporate affairs to assure that sales tax was collected and remitted (***Matter of Goodfriend***, ***supra***; ***see also Matter of Shah***, Tax Appeals Tribunal, February 25, 1999).

Petitioner argues that this case meets the exception because petitioner's agent, Mr. Aslan, was thwarted from exerting control over Club VIP. We note that petitioner adduced no proof that Mr. Marchello, himself, was thwarted from exercising authority over the organization (***c.f. Matter of Taylor***, Tax Appeals Tribunal, October 24, 1991 [wherein the taxpayer adduced evidence that he could not exercise authority out of fear for his life]; ***Matter of Defeo***, Tax Appeals Tribunal, March 9, 1995). Indeed, the record clearly establishes petitioner's authority to review the books and records, to receive copies of the quarterly sales tax returns, to meet with Mr. Aslan about the business, and to oversee the daily operation of the club. Petitioner presented no evidence to show that he was prevented from exercising this authority; yet, petitioner seeks to defend on the grounds that his agent, Mr. Aslan, was thwarted from complying with the tax obligations of the VIP Club and Club VIP.

Petitioner's argument must fail because the record establishes that actions of petitioner's agent, Mr. Aslan, also contributed to the financial infirmity of the VIP Club. Our review of the record reveals that, at the hearing before the Division of Tax Appeals, Mr. Aslan omitted key facts regarding his management of funds belonging to the club. These facts were presented at the

federal trial, the transcript of which is in the record, where Mr. Aslan testified under oath that, among other things, he took money from the VIP Club to start other clubs, appropriated over $30,000.00 from the club to support repayments of his personal loans, took at least three trips to the Super Bowl at the expense of the club, and maintained an apartment in Atlantic City at the club's expense. This indicates that petitioner's agent exerted actual authority over the VIP Club and Club VIP. The concealment of this important information injures the credibility of both petitioner and Mr. Aslan, and is entitled to the strongest negative inference.

Contrary to petitioner's argument that Mr. Aslan was thwarted from paying the taxes due because of the burdens that the mafia was allegedly placing on the club, Mr. Aslan admitted that he was able to fund other personal ventures using the club's receipts. Mr. Aslan admitted that he used the club's receipts to finance two separate businesses in New York City, to repay a $75,000.00 loan from his parents, as well as use the club's receipts for various personal and leisure activities. Mr. Aslan's testimony shows that he was not, in fact, thwarted from making payments from the club's receipts, but that he, instead, chose which payments to make, while using the balance of the receipts for other purposes. Moreover, the record shows that petitioner was aware that Mr. Aslan was using the club's receipts to pay for his personal ventures and did not oppose such use. Indeed, the testimony shows that petitioner was satisfied with the management of the club. Petitioner had the authority to prevent the misappropriation of funds and ensure that the club met its sales tax obligations, but chose to do nothing. Petitioner may not absolve himself by disregarding his fiduciary duty and leaving it to someone else to discharge (***Matter of Risoli v. Commissioner***, 237 AD2d 675 [1997]).

We note that petitioner correctly asserts that Messrs. Scala, Vargo, and Sassano are not

without fault. However, petitioner cannot absolve himself from responsibility by simply shifting blame to Messrs. Scala, Sassano and Vargo and stating that Mr. Aslan, who also misappropriated the club's funds, was thwarted from collecting and remitting taxes due. The record clearly shows that both Mr. Marchello and Mr. Aslan had sufficient authority to ensure compliance with sales tax obligations (***c.f. Matter of Taylor***, ***supra***; ***Matter of Defeo***, ***supra***). Moreover, we note that while Mr. Aslan may also be liable for the subject taxes, such liability does not absolve petitioner from liability, as the liability for sales and use taxes is joint and several (***see*** Tax Law §§ 1131[1] and 1133[a]; ***Matter of Pais***, Tax Appeals Tribunal, July 18, 1991; ***Matter of LaPenna***, ***supra***). Accordingly, we reject petitioner's argument that Mr. Marchello, through his agent, was thwarted from complying with his tax obligations, as this assertion is wholly unsupported by the record.

We also reject petitioner's argument as invalid because it is indistinguishable from arguing that the deficiency should be canceled because of a purported inability to pay. Petitioner advances the theory that Mr. Marchello, through his agent, Mr. Aslan, could not pay the taxes due because the actions of Messrs. Scala, Sassano and Vargo created a "major cash flow problem" (***see*** Hearing Transcript, p. 384).

We have previously held that the inability to satisfy a tax liability does not present viable grounds for relieving a taxpayer of its burden (***see Matter of Cerefice***, Tax Appeals Tribunal, January 16, 1997). There is no law or case that would permit reaching this conclusion. Further, to cancel the liability of the corporation's taxes would result in allowing petitioner, as well as Messrs. Aslan, Vargo, Scala and Sassano, to derive the benefit of operating the VIP Club at the expense of trust funds belonging to the People of New York (***see Matter of Byram***, Tax Appeals Tribunal, August 11, 1994 [the officer of a nonprofit corporation was liable for withholding taxes

although the monies were used to keep the hospital open]). Accordingly, we reject this argument because it lacks a legal basis.

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

These dance dollars constitute admissions fees within the meaning of Tax Law § 1105(f)(1). In ***Matter of 1605 Book Ctr. v. Tax Appeals Trib.*** (83 NY2d 240 [1990] ***cert denied*** 513 US 811 [1994]), the Court of Appeals upheld the imposition of sales tax on receipts of coin-operated peep show booths pursuant to Tax Law § 1105(f)(1) as places of amusement. The Court of Appeals held that the coins so deposited were a fee paid as an admission charge to a place where entertainment is provided and were subject to tax under Tax Law § 1105(f)(1). As stated by the Court of Appeals:

> there can be no doubt that the sales tax would apply if patrons viewed the same live performance in the company of other audience members in a theater (see, 20 NYCRR 527.10[b][3]). The booths are factually not taxably distinguishable from a usual theater except for the element of privacy. Accordingly, the fee paid is an admission charge to a place where entertainment is provided . . . (***Matter of 1605 Book Center v. Tax Appeals Trib.***, ***supra*** at 245).

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

Herein, the VIP Club patrons used dance dollars to purchase exotic dances both "in the open" and in private rooms, with the receipts collected by Club VIP. These transactions are identical to those presented in ***Matter of 677 New Loudon Corp.***, (***supra***) and ***Matter of 1605 Book Ctr.***, (***supra***). The use of a shell corporation to manage and collect the exotic dance receipts does not affect the basis for the imposition of tax. As such, the receipts of Club VIP from the purchase of exotic dances are properly subject to sales tax on the same grounds (i.e. Tax Law §§ 1105[d], [f][1], and [f][3]). Petitioner has not challenged nor introduced evidence regarding the taxability of either the license or handling fees paid by the dancers to Club VIP. Petitioner failed to overcome the presumption of correctness with respect to these receipts (***see Matter of Tavolacci v. State Tax Commn., supra***), which we also deem as properly taxable. Accordingly, we hold that all receipts of Club VIP are properly subject to sales tax.

We find that petitioner has not proven, by clear and convincing evidence, that either the audit methodology nor the amount assessed was unreasonable (***see Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858 [1981]). On audit, the Division made several proper requests for records and met with Mr. Aslan several times. However, the Division was never provided with any source documentation and, therefore, properly determined that the club failed to maintain adequate records. The Division properly resorted to an audit based on external indicies (***see Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576 [1982]). We find that the audit methodlogy used by the Division was reasonable under these circumstances, and that petitioner failed to prove, by clear and convincing evidence, that the result of the audit was unreasonably inaccurate or that the amount of the tax assessed was erroneous (***see Matter of Sarantopoulos v. Tax Appeals Trib.***, 186 AD2d 878 [1992]).

Finally, we hold that petitioner failed to provide reasonable grounds for the abatement of penalties. As stated above, the record does not support the argument that either petitioner or Mr. Aslan were prevented from collecting or remitting sales tax. We reject the testimony of Mr. Aslan stating that he made every effort to meet the tax obligations of Club VIP because he, himself, was appropriating funds from Club VIP for his own gain. Finally, we have held that reasonable reliance upon the advice of an accountant or tax professional does not provide "reasonable cause" for the abatement of penalty (***see Matter of Dougherty Towing Co.***, Tax Appeals Tribunal, April 12, 1990).

We have considered petitioner's remaining contentions and found them to be either without merit or moot, given the foregoing discussion.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted to the extent that Frank A. Marchello (deceased) is liable for the sales and use taxes due from Club VIP as a person responsible for the collection and payment of sales tax; that the audit and assessment of sales tax was proper; and that penalties were properly imposed;

2. The exception of Frank A. Marchello (deceased) is granted to the extent that the Notice of Determination, dated February 10, 2005, is cancelled for the period January 30, 2002 through August 31, 2002, but in all other respects is denied;

3. The determination of the Administrative Law Judge is reversed to the extent indicated in paragraph "1" above, but otherwise is affirmed;

4. The petition of Frank A. Marchello (deceased) is granted to the extent indicated in paragraph "2" above, but in all other respects is denied; and

5. The Notice of Determination, dated February 10, 2005, is cancelled to the extent indicated in paragraph "2" above, but in all other respects is sustained.

DATED:Troy, New York
April 14, 2011

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner