STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
1605 BOOKCENTER, INC.	:	DETERMINATION
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 March 1, 1976 through August 31, 1979.	:	

Petitioner, 1605 Bookcenter, Inc., c/o C & F Merchandise Company, 303 West 42nd Street, New York, New York 10036, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1976 through August 31, 1979 (File No. 800121).

A hearing was commenced before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on August 1, 1989 at 9:15 A.M. and continued to conclusion on August 2, 1989 at 9:15 A.M., with all briefs to be submitted by March 14, 1990. Petitioner appeared by Herald Price Fahringer, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether petitioner maintained and made available to the Division of Taxation adequate and complete books and records from which the exact amount of tax due could have been determined.

II. Whether, if adequate books and records were not maintained, the test period markup audit of petitioner's bookstore sales was reasonable.

III. Whether petitioner's receipts from the sale of certain publications were exempt from sales tax under section 1115(a)(5) of the Tax Law because they were receipts from the sale of periodicals.

VI. Whether charges imposed by petitioner for the viewing of live performances through a coin-operated apparatus were subject to sales tax.

V. Whether charges imposed by petitioner for admission to a theatre where motion pictures and live performances were shown were subject to sales tax.

VI. Whether the sales tax audit was conducted in a discriminatory manner or for the purpose of curtailing petitioner's First Amendment rights.

FINDINGS OF FACT

On July 21, 1980, the Division of Taxation issued to petitioner, 1605 Book Center, Inc., a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1976 through August 31, 1979, assessing tax due of $141,686.11 plus interest. No tax was assessed for the period September 1, 1976 through August 31, 1977.

Petitioner operated a commercial establishment in New York City's Times Square area. It was in the business of selling books, magazines, newspapers and novelty items, operating a theater where movies were exhibited and live performances were given, and providing "peep" shows. Its entire business was sexually oriented and all materials and performances offered to its patrons were sexually explicit.

An audit of 1605 began in or around May 1979. By letter dated May 7, 1979, the Division informed petitioner that a field examination of petitioner's books and records for the period March 1, 1976 through February 28, 1979 had been scheduled for May 14, 1979. The letter stated: "All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates, etc. and all Sales Tax records." The following books and records were made available by petitioner: sales tax returns and related worksheets, Federal income tax returns and related worksheets, a sales journal, a purchases journal, some purchase invoices, and a general ledger. These records were judged to be in good condition.

Petitioner's general ledger showed gross receipts broken down into three categories: taxable [bookstore], nontaxable [bookstore] and vending machines. The auditor was informed that petitioner considered one-third of its bookstore sales to be taxable. All other receipts from all other sources were deemed by petitioner to be nontaxable. None of the auditors who participated in this audit were available to testify, and it is not possible to determine from the audit documents the exact nature of the charges included in each of the three categories shown in the general ledger. The Field Audit Report indicates that four categories of sales were included by the Division under the general heading "vending machines and other income": (1) sales income from live burlesques shows; (2) sales income from live peep shows; (3) sales income from vending machines; and (4) sales income from film viewers. All of these receipts were determined by the Division to be subject to sales tax. Total vending machine and other receipts as shown in petitioner's general ledger were $1,577,592.32, with a tax due on that amount of $126,207.39.

The Division performed a test period markup audit of petitioner's bookstore sales. The narrative portion of the field audit report provided only a minimal description of the audit methodology employed; however the audit workpapers were detailed and did demonstrate the method used.

(a) The test period selected was June 1978. Petitioner supplied invoices from two suppliers: Model Distributors and Century Sales Company.

(b) The auditor listed each invoice on a columnar sheet by date, invoice number and the total amount of each invoice. A fourth column was headed "taxable purchases". Publications with the following titles were deemed to be nontaxable purchases: Advocate, Screw, Pleasure, Hook, Unique, Swing, Black and several publications identified only by initials. All other publications were deemed taxable, including publications identified on the invoices only as magazines, comics or by order number or title. Those publications deemed nontaxable were not included in the markup test figures. Century invoices showed only two items, dolls and unspecified magazines; the former were films purchased for use in the film viewing booths and

for sale in the bookstore.

(c) The Model invoices generally showed a "cover price", quantity, unit purchase price, and total purchase price for each item listed. The auditor applied the cover price to the number of items purchased to calculate total taxable sales of each item. Taxable sales of each item were totaled on each invoice and entered on the auditor's worksheet as "taxable at selling". This category will be referred to here as audited taxable sales. Where a cover price was not shown, the auditor marked up purchases on the Model invoices by 50 percent to determine the selling price. This percentage was obtained from an individual identified in the record only by name. Total purchases shown on the Century invoices were marked up 100 percent to determine a selling price. The basis for this markup percentage is not in the record.

(d) Both Model and Century issued credit invoices for returned items. Amounts on the credit invoices were subtracted from total purchases and taxable purchases. For the purpose of determining audited taxable sales on returned items, total credit given was marked up 66 percent on Model invoices and 100 percent on Century invoices. Using this method the auditor determined that total purchases from Model were $6,952.42; taxable purchases were $4,847.34 and audited taxable sales were $7,916.60. From the Century invoices, total purchases were $5,009.95 (including a shipping and handling charge of $6.20), taxable purchases were $5,003.75, and audited taxable sales were $10,007.50. The auditor determined that petitioner purchased some films for use in its 46 film viewing machines, rather than for resale, and an adjustment was made to reflect this fact. After this adjustment was made, total purchases were determined to be $11,962.37, taxable purchases were determined to be $8,471.05, and audited taxable sales were determined to be $15,164.10. Taxable purchases were divided by total purchases to calculate a taxable ratio of 70.81 percent. The auditor also calculated a markup of 79.01 by subtracting taxable purchases from audited taxable sales and dividing the result by audited taxable sales.

(e) Additional taxable bookstore sales were determined by applying the taxable ratio to total purchases as shown in petitioner's records to determine audited taxable purchases. The

markup percentage of 79.01 was applied to audited taxable purchases to calculate audited taxable sales of $406,487.00. An error rate of .9084 was determined from a mathematical comparison of reported taxable sales to audited taxable sales. Application of the error rate to reported taxable sales yielded additional taxable sales of $193,484.00 with a tax due on that amount of $15,478.72. No tax was assessed for the period June 1, 1976 through November 30, 1977.

As an adjunct, or more likely a preliminary, to the markup test, the auditor prepared a schedule, segregating purchases shown on the June 1978 invoices into four categories: papers, pocket books, magazines and novelties. The publications placed in the category of "papers" were the same as those determined to be nontaxable in the markup test. Publications identified only as magazines or comics were placed in the category magazines. Publications clearly identified as books, those having a cover price of less than three dollars and those identified only by order number were classified as pocket books. All other publications were classified as magazines. In the markup test audit, all magazines were deemed taxable.

When conducting a test period audit of a bookstore selling sexually explicit materials, the Division currently instructs auditors to examine each publication on sale during the test period, to record the title of the publication and some information about the contents, and to indicate whether the publication is issued periodically. There is no evidence in the record that this procedure was followed here.

On August 1, 1989, petitioner and the Division of Taxation entered into a stipulation which is adopted here as Finding of Fact "9". It is supplemented by additional facts as indicated.

Stipulation

WHEREAS the parties agree that the following facts are true:

(a) That for the sales tax quarters in issue, the petitioner was a corporation engaged in business in New York State, offering to the public various forms of adult entertainment, and selling tangible personal property.

(b) That some sales made by the petitioner were not subject to a sales tax; some were; others are in dispute.

(c) That among those that were not, were receipts generated by patrons viewing films in "peep" show machines, regardless of whether the machine was or was not housed in a booth.

(d) That other forms of entertainment and tangible personal property offered by the petitioner to the public on the petitioner's premises included the following:

(i) Store - - The vendor sells the following merchandise: publications; newspapers; books; films; video movies; adult sexual aids, devices and games.

(ii) Live "Peep Shows" - - This is now more commonly known in the industry as "peep-a-live" shows or "live peep shows". It consists of several coin-operated machines, housed in private booths that surround a stage on which nude or partially nude females perform. A glass partition separates the patron from the performers. For each minute that the patron wishes to view the performer, he must deposit a token valued at $0.25 into a machine which raised a partition in front of the glass.

(iii) Motion Pictures Films and Live Shows - - In a theater area on the second floor of the premises, nude female performers occasionally perform on stage. Also, feature length motion picture films and short films are exhibited in the same area. For an admission of $5, the patron can remain in the theater area for an unlimited period of time.

(iv) Private Peep Shows - - Similar to (ii) above, this is now more commonly known in the industry as "one-on-ones", or "fantasy booths". It consists of a coin-operated machine housed in a private booth which operates a glass partition which separates the patron and the female performer who is dressed in abbreviated attire. The patron can view the performer through the glass partition for a limited time and at the same time speak with her over an intercom system. For each minute that the patron wishes to continue to either view or speak with the performer he must deposit a token which has a higher value than the token required for the live peep shows.

(e) That, as described, these forms of entertainment are common to the "adult entertainment" industry and as presented, are the same as those presented in other "adult entertainment establishments" in New York City and elsewhere - - except that in some establishments they follow an "open-window policy" in the "peep-a-live" and the "one-on-ones", the patron is allowed to touch the female performer. 1605 Bookcenter did not permit "open windows" or any touching between the patron and the performer.

(f) That the use of the terms "performance", "performer", "dance", and "dancer" in this stipulation is not meant to constitute an agreement or disagreement that the live peep shows, live shows and/or private "peep shows" are musical or dramatic arts performances within the

meaning and intent of Tax Law § 1105(f)(1).

(g) That, during the audit period, the petitioner also made sales from vending machines located on its premises.

(h) That, except for taxable receipts constituting "vending machine sales and other income" (audit workpaper 12), the petitioner's store was leased out during the period 6/1/76 -- 11/30/77, and the petitioner had no other taxable receipts during those periods.[1]

(i) That, based upon the expiration of the applicable period of limitations, the Audit Division cancels taxes, penalties and interest assessed for the period 3/1/76 - 5/31/76.

(j) That, based upon the recent holding in Adamides v. Chu (134 AD2d 776 [3d Dept 1987]), the Audit Division cancels taxes, penalties and interest assessed for the periods 3/1/79 - 8/31/79.

(k) The Division of Taxation does not object to the amended petition dated April 27, 1983, but denies each and every allegation contained therein. The petitioner does not object that it has not been served with an answer to this amended petition, and agrees that, except for those matters stipulated and agreed to herein, the issues raised in the amended petition are in dispute.

It is therefore STIPULATED AND AGREED by and between the undersigned attorneys of record for the petitioner and the Division of Taxation that the above facts shall become the facts of the above matter and shall not be disputed by either party at the formal hearing to be held in this matter.

Additional Findings of Fact

Petitioner's business is no longer in operation. The only witness who was on the premises of 1605 during the audit period was Dr. Charles Winick, who was qualified as an expert in the field of so-called "adult entertainment". Dr. Winick visited 1605 in 1978 and 1979. He testified that the mechanics for observing a peep show movie, a live peep show and a

[1]Audit workpaper 12 indicates that no sales were made in the category of "Vending machines and other income" for the period September 1, 1976 through September 30, 1977.

private show were essentially the same. The patron entered a booth with a door that could be closed behind him. He placed coins in a slot which caused a screen or curtain to rise and enabled him to view a show of some sort, either live or on film. The booth provided the patron with privacy, screened out noise and light and ensured that each patron paid a separate charge for viewing. When coins or tokens were placed in the slot, a light went on outside the booth to indicate that the booth was in use. The length of the patron's viewing time was controlled by the number of tokens he placed in the slot. When his time ran out, the screen or curtain came down, and the patron exited the booth.

Dr. Winnick personally observed a theater located on the second floor of 1605. The theater was described as being approximately 15 feet by 20 feet and large enough to hold about 50 patrons. The movies shown at that time were generally feature length pornographic films such as "Deep Throat" and "Behind the Green Door". The films were shown continuously from approximately noon until 11:00 P.M., interspersed by live performances of approximately 15 to 20 minutes in length.

At the request of petitioner's counsel, Dr. Winick conducted a survey in 1978 of publications sold by petitioner. He examined every publication in a magazine format, identifying its contents, format, publisher, date of publication, and evidence of serial publication such as a volume number, issue number and year. He inspected 351 publications and found only 29 that lacked evidence of serial publication. The publications he examined typically contained pieces of fiction and separate articles on a variety of topics.

Petitioner offered the testimony of Scott Wexler, the comptroller since 1985 of C & F Merchandising, a holding company for 1605 and other affiliated companies, to describe the accounting methods and procedures in effect during the audit period. Mr. Wexler's testimony was based on his familiarity with petitioner's accounting system and procedures and conversations with persons employed by petitioner during the audit period. He stated that receipts from peep shows were not segregated according to the type of entertainment being provided because all peep show receipts were considered to be nontaxable. The peep show

apparatus included a meter which registered the number of coins placed in the receptacle. Approximately twice a week, an employee opened the coin receptacles, collected the monies inside, read the meters and entered the meter reading for each individual apparatus on a columnar sheet. The meter readings were used as an internal control. After the monies collected were verified against the meter readings, the sheets were discarded. According to Mr. Wexler, the category in the general ledger entitled "vending machines" included receipts from the peep shows and from the theater.

Mr. Wexler testified that the bookstore used a cash register which produced a tape. The tapes were kept for at least three years. No tapes were produced at hearing. According to Mr. Wexler, petitioner and its affiliated companies regularly perform their own tests to determine what portion of their bookstore sales are subject to sales tax. Petitioner estimated that one-third of its bookstore sales were taxable based on such a test.

Mr. Wexler performed his own calculations to estimate gross receipts from the different types of peep shows.

(a) Total revenue from all operations, taken from petitioner's books and records, was stated to be $1,404,000.00 for the period March 1, 1976 through February 28, 1979.[2] Bookstore receipts, again taken from petitioner's records, were $413,278.00. The remaining $990,722.00 was revenue from coin operated peep shows and the theater.

(b) Mr. Wexler stated that the average movie peep show collected approximately $25.00 per day and 50 such machines were in operation during the audit period. By simply multiplying the number of machines, times average receipts of $25.00, times the number of days in a sales tax quarter (the machines were in operation 24 hours per day, 7 days per week), he estimated quarterly receipts. Quarterly receipts were aggregated to estimate total receipts for the audit period of $604,501.00. Receipts from the live peep shows and private peep shows were estimated in the same fashion. Mr. Wexler estimated that these booths collected only $10.00 per day primarily because they were operated fewer hours per day and fewer days per week.

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[2]Petitioner's sales tax returns for this period reported gross sales of $1,027,494.00.

Petitioner operated 18 live peep show booths and 5 private peep show booths during the audit period. Total receipts from these booths were estimated at $87,353.00 and $24,568.00 respectively.

(c) Theater revenue was estimated by subtracting receipts from the peep shows from total receipts. It amounted to $274,300.00.

(d) According to Mr. Wexler's calculations, the film viewing machines accounted for approximately 59 percent of all revenue from sources other than the bookstore. The live peep shows accounted for approximately 9 percent of such revenue; the private peep shows accounted for approximately 3 percent of such revenue; and the remaining 29 percent of this revenue was produced by the theater.

Petitioner presented the testimony of Mr. Ralph Schwarz, an attorney representing MJM Enterprises, which operates a business similar to that operated by petitioner. In the course of a sales tax audit of MJM, Mr. Schwarz was informed by the Division that coin-operated machines are not subject to sales tax. He communicated this information to MJM's accountant, Norman Waxman, who wrote to the Division's Technical Services Bureau to confirm that information. By letter dated January 10, 1983, the Division advised Mr. Waxman that coin operated machines for viewing films were not subject to sales tax. Mr. Waxman again wrote to the Division asking whether the Division's opinion would also apply to coin operated machines for viewing of a live performance. By letter dated May 5, 1983, a Division employee advised as follows:

> "Pursuant to the findings of the court in Bathrick Enterprises vs. Murphy the receipts from coin operated amusement devices are not for the rental of tangible personal property nor an admission charge to a place of amusement. We find little difference between a coin operated device which allows viewing of a live performance and those addressed in Bathrick. Both devices are permitted to operate and function by the insertion of a coin and neither grant the patron admittance to a place of amusement. Accordingly, it is our opinion that the receipts from these devices are not subject to the sales tax."

As the result of a sales tax audit, MJM Enterprises was assessed $580,000.00, including penalty and interest, premised upon the ground that MJM's receipts from all coin-operated machines were subject to sales tax. The tax assessed on such receipts was cancelled following a

conciliation conference conducted by the former Tax Appeals Bureau.

Petitioner presented the testimony of Dr. Winick and Mr. Schwarz to support its contention that the sales tax assessment in dispute was conducted as part of a plan to rid the Times Square area of sexually oriented businesses. Dr. Winick testified that a major goal of the redevelopment program in Times Square was to close down businesses specializing in sex. He stated that police, building and fire inspectors were employed by the Midtown Enforcement Project to harass such businesses and involve them in costly legal proceedings. Mr. Schwarz testified that the City routinely made illegal arrests and seizures of films and projectors in order to disrupt these businesses. Petitioner's representative cited a number of court cases which document petitioner's claim that sex oriented businesses in Times Square were victims of selective law enforcement during the audit period.[3]

The Division was unable to present any witness who was present in 1605 during the audit period. Two witnesses testified regarding their observations, made within several days of this administrative proceeding, of activities taking place in an establishment similar in nature to 1605 called Show World. One of those witnesses, Dr. Camille Hardy, was qualified as an expert in the field of dance. It was her opinion that the performances she observed were not works of art. The precise nature of the activities engaged in by performers in the 1605 theater is a matter of dispute between the parties. However, the testimony presented by the Division did not contradict the general description of the activities taking place in 1605 as set forth in the Stipulation,[4] and the testimony of Dr. Winick.

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[3]See, Show World Center, Inc. v. Walsh, 438 F Supp 642; Blackjack Distributors, Inc. v. Beame, 433 F Supp 1297. In both of the cited cases, the courts found substantial evidence that City agencies were engaged in a course of conduct that threatened the plaintiff's First Amendment rights.

[4]The parties stipulated that there was a theater area on the second floor of 1605 where feature length films and short films were exhibited and live performances were given.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner takes the following positions with regard to each of the individual issues in dispute:

(a) Petitioner argues that its books and records were adequate for the purpose of verifying its reported taxable sales, hence resort to a test period markup audit was not authorized by the Tax Law.

(b) Petitioner contends that the testimony of Dr. Winick was adequate to prove that 92 percent of the publications sold by 1605 qualified as periodicals under the regulations set forth by the Commissioner of Taxation and Finance. Alternatively, it argues that section 1115(a)(5) of the Tax Law, exempting newspapers and periodicals from sales tax, is unconstitutionally vague and overbroad, and that 20 NYCRR 528.6[c], defining the term "periodical", is unconstitutional on its face and as applied here. Petitioner also argues that placing the burden of proof upon petitioner to establish that it qualifies for the tax exemption for newspapers and periodicals is a violation of petitioner's rights under the Federal and State constitutions.

(c) Petitioner argues that the live peep shows and private peep shows are not "places of amusement" as that term has been defined by New York's courts and hence receipts from the peep shows are not subject to sales tax.

(d) Petitioner states that the theater located in 1605 was a movie theater and as such was exempt from sales tax under section 1105(f)(1) of the Tax Law, even though the film showings were interspersed by live performances. Although petitioner initially argued at hearing that the performances were exempt from sales tax as "dramatic or musical arts performances", it apparently abandoned this position and made no arguments in this regard in its brief.

(e) Finally, petitioner maintains it is the victim of selective enforcement of the sales tax law which in itself is a ground for cancellation of the tax assessment.

The Division takes the following position with regard to the items in dispute:

(a) The Division contends that petitioner's records were inadequate and insufficient to verify reported taxable sales thus justifying resort to a test period audit to determine petitioner's

tax liability.

(b) The Division maintains that each booth housing a live peep show and private peep show was a separate "place of amusement", hence the charges collected by the coin-operated machines were charges for admission to a place of amusement, taxable under section 1105(f)(1) of the Tax Law.

(c) The Division maintains that Dr. Winick's testimony did not establish by clear and convincing evidence the nontaxability of any of petitioner's receipts from the sale of publications. The Division disputes petitioner's contention that it is a violation of petitioner's constitutional rights to place the burden of proof on petitioner to show that its receipts from the sale of printed material were not subject to tax.

(d) Based on the testimony of Dr. Hardy, the Division claims that it carried its burden of proof to show that charges for admission to the theater operated by 1605 were not charges for admission to a dramatic or musical arts performance. The Division further argues that the live performances provided in the 1605 theater were the featured attractions and that the movies were merely "fillers". On this ground, the Division maintains that charges for admission to the theater were not excluded from tax as admissions to a movie theater.

CONCLUSIONS OF LAW

A. Every person required to collect tax must maintain records sufficient to verify all transactions, in a manner suitable to determine the correct amount of tax due (Tax Law § 1135[a]; 20 NYCRR 533.2[a]). These records must be made available for the Division's inspection upon request (20 NYCRR 533.2[a][2]). Among the records required to be maintained are "records of every sale or amusement charge" and the tax due on that sale or charge (Tax Law § 1135[a]).

When conducting an audit, the Division of Taxation may not simply ignore a taxpayer's records if those records provide an adequate basis on which to determine the amount of tax due (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41); however, the Division is not required to rely upon a taxpayer's non-source documentation and determine the

amount of tax due based upon documents which cannot be verified (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, lv denied 44 NY2d 645; see also, Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal, May 11, 1989).

To determine the adequacy of a taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NY2d 826, lv denied 71 NY2d 806; Matter of King Crab v. State Tax Commn., 134 AD2d 51, 522 NYS2d 978). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn., supra; Matter of Ronnie's Suburban Inn, supra). In the absence of adequate books and records, the Division is authorized to determine the amount of tax due on the basis of the information available and may resort to external indices if necessary (Tax Law § 1138[a][1]; Matter of Carmine Restaurant v. State Tax Commn., 99 AD2d 581, 471 NYS2d 402).

B. Petitioner's first contention is that its books and records were adequate for the purpose of verifying its taxable sales; therefore, the Division lacked the statutory authority to conduct a test period audit of petitioner's business operations. This contention does not stand up to scrutiny. First, the appointment letter dated May 7, 1979 is sufficient evidence that the Division requested all of petitioner's books and records for the period March 1, 1976 through February 28, 1979, including cash register tapes and sales invoices (see, Matter of Great Neck Service Station, Tax Appeals Tribunal, May 26, 1988). While petitioner made available to the Division all of its ledgers and journals, or books of original entry, it is undisputed that petitioner did not maintain records of individual sales from which its ledgers and journals could be verified. Mr. Wexler testified that the peep show apparatus included a meter which petitioner used to maintain internal controls. These meter readings would have provided a means of verifying the figures recorded in petitioner's books, but they were destroyed after several months. Cash register tapes were maintained for a period of three years, but they would not

have provided the auditor with a basis for determining whether tax had been charged on all taxable items; therefore, even if made available, the tapes would have been useless for audit purposes (see, Matter of Licata v. Chu, 64 NY2d 873; 487 NYS2d 552).

To a great extent, the audit here, and the tax determined to be due, was premised upon petitioner's own books and records. The total amount of petitioner's gross receipts from all sources was taken by the Division from petitioner's general ledger. The test period audit was used only to determine whether petitioner accurately reported taxable sales of tangible personal property sold in its bookstore. Petitioner admitted, to the auditor and at hearing, that it estimated its taxable sales through its own testing procedures. Since petitioner did not maintain a verifiable record of individual sales, the Division was warranted in conducting its own test period audit to determine the accuracy of petitioner's records.

C. Petitioner challenges the imposition of sales tax in three areas: the tax on publications sold in its bookstore; the tax on receipts collected through coin-operated machines; and the tax on admission charges to the theater. Each of these raise different issues of law and fact.

D. Tax Law § 1105(a) imposes a sales tax on receipts from every retail sale of tangible personal property. Tax Law § 1115(a)(5) exempts from tax the receipts from the sale of "newspapers and periodicals". The statute does not provide a definition of either. On January 31, 1979, the former State Tax Commission promulgated a regulation defining the term "periodical", effective January 31, 1979. 20 NYCRR 528.6(c)(1) provides:

> "(1) In order to constitute a periodical, a publication must conform generally to the following requirements:
>
> (i) it must be published in printed or written form at stated intervals, at least as frequently as four times a year;
> (ii) it must not, either singly or, when successive issues are put together, constitute a book;
> (iii) it must be available for circulation to the public;
> (iv) it must have continuity as to title and general nature of content from issue to issue; and
> (v) each issue must contain a variety of articles by different authors devoted to literature, the sciences or the arts, news, some special industry, profession, sport or other field of endeavor."

Tax Law § 1132(c) creates a presumption that all receipts for the sale of tangible personal

property are subject to sales tax and places the burden of proving otherwise on the taxpayer. As a general rule, statutory exemptions from tax are strictly construed against the party claiming the exemption and the claimant must clearly establish his right to the exemption (Grace v. New York State Tax Commn., 37 NY2d 193, 196, 371 NYS2d 715).

Citing Speiser v. Randall (357 US 513), petitioner argues that, because its free speech rights are implicated, it is unlawful to place the burden of proof on petitioner to show entitlement to the statutory exemption for periodicals. It is no secret that allocation of the burden of proof is often determinative of the outcome of an issue. For that reason, it is necessary to treat this argument first. In Speiser, war veterans claiming a property tax exemption provided for in the California Constitution were required to sign a loyalty oath which, among other things, stated that they did not advocate violent overthrow of the government. Those who refused to sign the oath were denied the tax exemption, but signing the oath did not insure entitlement to the exemption since the tax assessor was still free to investigate facts and deny the exemption. In either case, California law placed the burden upon the claimant to prove eligibility on the administrative level and upon judicial review. The Court found that a State may deny a tax exemption to persons who actually engage in certain forms of proscribed speech, but held that the State must bear the burden of proof to show that the tax claimant engaged in criminal speech before denying the tax exemption on that basis (Speiser v. Randall, supra). The situation in Speiser has no parallel here. The California statute explicitly sought to condition entitlement to a tax exemption on the basis of the content of certain speech. The New York statute is neutral as to content. Furthermore, New York's courts have rejected the argument that, in discriminating between different types of publications, section 1115(a)(5) of the Tax Law is an infringement on freedom of the press or a denial of equal protection (Matter of Twin Coast Newspapers v. State Tax Commn., 101 AD2d 977, 477 NYS2d 718; Matter of G & B Publishing Co. v. Department of Taxation and Finance, 57 AD2d 18, 392 NYS2d 938, lv denied 42 NY2d 807). In light of those decisions, it is concluded that requiring petitioner to shoulder the burden of establishing entitlement to the exemption for periodicals is

not a denial of its due process rights.

Petitioner's position is that it met its burden through the testimony of Dr. Winick. Dr. Winick was qualified as an expert in the field of "adult entertainment". He studies the sex industry. He personally inspected magazines and newspapers sold by petitioner during the audit period and determined that 92 percent of those publications satisfied the requirements set forth in 20 NYCRR 528.6(c)(1).[5] Dr. Winick's testimony was uncontroverted by either witnesses or documentation. The audit report does not disclose the criteria employed by the Division in determining whether publications sold by petitioner were periodicals as the term is used in the Tax Law. The Division's representative assumed, as part of his legal argument, that the auditor reviewed the various publications and applied the criteria found in the regulation. But there is no evidence in the record to prove whether this was done. Moreover, no one employed by the Division during the audit period testified as to the general procedure followed by the Division during the time of the audit. The audit workpapers suggest that the auditor worked directly from the purchase invoices. All items classified on the invoices as magazines were categorized as taxable purchases while all newspapers were classified as nontaxable purchases. It is interesting to note that the term periodical was not used by the auditor. While the Division is not responsible for demonstrating the propriety of its assessment (Matter of Blodnick v. State Tax Commn., 124 AD2d 437), there must still be facts in the record from which an independent decisionmaker can determine whether a rational basis existed for the auditor's calculations (Matter of Grecian Square v. State Tax Commn., 119 AD2d 948, 501 NYS2d 219; Matter of Estate of Alice M. Fashana, Tax Appeals Tribunal, September 21, 1989). In this case, there is

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[5]Petitioner notes that 20 NYCRR 528.6 was not promulgated until the very end of the audit period, and it argues that in determining whether its publications satisfied the statute the common law definition of a periodical should apply. In G & B Publishing Co. (supra) the court held that in the absence of a regulatory definition of a periodical, it is appropriate to resort to a "test of common understanding influenced by authority from collateral sources". It is not apparent that the regulation departs from this general understanding, and petitioner has not offered an alternative definition of the term. Accordingly, it is found that the regulation does not significantly depart from the common law definition (see, Matter of Blackjack Distributors, State Tax Commission, May 6, 1983 [TSB-H-83(131)S]).

no evidence in the record to show what criteria was applied in arriving at the determination that no magazines sold by petitioner satisfied the definition of a periodical. Inasmuch as there is no evidence in the record to the contrary, Dr. Winick's testimony is sufficient to establish that 92 percent of the magazines sold by petitioner were periodicals. The Division is directed to recompute the taxable ratio which resulted from the test period audit test and petitioner's tax liability, accordingly.

E. The next issue is whether receipts from the coin-operated peep show machines were subject to sales tax. Tax Law § 1105(f)(1) provides, in pertinent part, that a sales tax should apply to "[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". The term "place of amusement" is defined by Tax Law § 1101(d)(10) as "[a]ny place where any facilities for entertainment, amusement, or sports are provided", and the term "admission charge" is defined by Tax Law § 1101(d)(2) 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".

The issue before the Appellate Division, Third Department in Matter of Fairland Amusement v. State Tax Commn. (110 AD2d 952, 487 NYS2d 879) was whether the sales tax imposed by Tax Law § 1105(f)(1) applies to amusement ride tickets for individual carnival rides. Affirming the determination of the State Tax Commission, the court held that the sales tax applied, since the charge was "for entertainment or amusement or for the use of facilities therefor" (Tax Law § 1101[d][2]). The Court of Appeals reversed, adopting the logic of the dissenting opinion below (Matter of Fairland Amusement v. State Tax Commn., 66 NY2d 932, 498 NYS2d 796). The Court found that there is an ambiguity in the taxing statute. When the provision imposing the tax is read in conjunction with the applicable definitions, "place of amusement" may be interpreted as meaning only the physical space within which entertainment or amusement facilities are provided or the amusement facility itself. Citing the general principle that any ambiguity in the statutory scheme must be construed most strongly in favor of the taxpayer, the court found that the sales tax does not apply to charges for the use of

amusement facilities, but only to "an admission charge to enter the location where amusement facilities are found" (Matter of Fairland v. State Tax Commn., supra, 487 NYS2d 879, 880, J. Mikoll, dissenting). The question before us then distills to whether a peep show is "[a] place where any facilities for entertainment [or] amusement...are provided" (Tax Law § 1101[d][10]).

The Division concedes that charges for the use of automated movie viewing machines (movie peep shows) are not subject to sales tax, but nonetheless contends that the live peep shows and private peep shows are "places of amusement" and hence are subject to sales tax. The Division's position is that the booths which the patrons entered to view the live shows in themselves constituted "places of amusement". Petitioner, on the other hand, equates the peep shows to jukeboxes, video games and other such coin-operated amusement devices. This provides a concrete resolution to this issue since such "devices for amusement" are clearly outside the scope of the Tax Law (see, Matter of Bathrick Enterprises v. Murphy, 23 NY2d 664, 295 NYS2d 489). Petitioner points to the New York City Administrative Code § 11-1501.2 which explicitly includes "apparatus booth" within the definition of a "[c]oin operated amusement device" for purposes of applying a tax on such devices, and to the opinions of several Division employees in the MJM case, as persuasive authority for categorizing the peep shows as amusement devices. Neither of these were considered determinative of the issue before us. It is apparent that live peep shows differ from mechanical devices for amusement in that they involve the viewing of a live performer. In fact, the essense of this commercial transaction was the collection of a charge to watch a live sex show. To treat the charge collected by 1605 as one imposed for the use of a "device for amusement" ignores or distorts the reality of the transaction. Moreover, such a treatment comes perilously close to denominating the performer herself as a "device for amusement". For these reasons, Bathrick is deemed not to control here. The question then remains whether the booths themselves are "places of amusement" as that term is used in the taxing statute.

The facts are not in dispute. The patron entered a booth, shut a door behind him, and placed coins or tokens in a slot; a screen or curtain then rose revealing a person who performed

for an audience.[6] The booth, coin box, screen and mechanical device for raising the screen were all part of one apparatus. The charge was imposed for the privilege of watching a live performance. It was collected after the patron entered the booth. The amount of the charge was related to the length of the viewing time. Admission to that area of the premises where the booths were located was free.

The mechanical elements of the booth apparatus, i.e., the coin receptacles and rising screens, were the means of collecting the charge and controlling the viewing time, but the reason for entering the booth was to watch the performance. There is no doubt that the sales tax would apply if patrons entered an auditorium to view the same performance in the company of other audience members. The booths are distinguishable from an auditorium primarily in affording the patron an element of privacy. What is certain at this point in the discussion is that the patron entered a place (the booth) where entertainment was provided. The critical factor then is the nature of the charge collected. Was it an amount paid for admission to a place where entertainment was provided? Clearly, it was. That the charge was collected after the patron entered the booth by means of a coin-operated device is not of determinative legal significance. Keeping in mind that where there is an exclusion under the Tax Law the statute must be construed strictly in favor of the taxpayer (Matter of Grace v. State Tax Commn., supra), and that the statute must be interpreted as an ordinary person would read it (Matter of Fairland Amusement v. State Tax Commn., 487 NYS2d supra), it is found that the individual booths were "places of amusement" as that term is used in the Tax Law.

F. The next issue is whether admission charges to the theater located on the second floor of 1605 were subject to sales tax. Tax Law § 1105(f)(1) imposes a tax on admission charges to "any place of amusement" except "motion picture theaters". "[A] motion picture theater means any place in which people congregate for the showing of a film" (20 NYCRR 527.10[c][3]). Dr. Winick's testimony was sufficient to establish that 1605's theater was such a place, and the

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[6]For the purposes of Tax Law § 1105(f)(1), the differences between the live peep shows and private peep shows are insignificant.

Division conceded as much by stipulation. The Division now contends that 1605's theater is not excluded from the operation of the Tax Law on the ground that the showing of motion pictures in 1605's theater was merely incidental to the live performances which also took place there. This assertion is not supported by facts in the record. Moreover, the regulatory definition of a motion picture theater contains no words of limitation which would support the Division's argument.

G. The Division has conceded that petitioner's receipts from the operation of the movie peep shows were not subject to sales tax. In addition, it has been found here that petitioner's receipts from charges for admission to the theater were excluded from the sales tax. Petitioner's records did not segregate these charges from those found to be subject to tax, notably the live peep shows. Since the audit proceeded on the theory that all of these charges were subject to tax, no attempt was made by the auditor to determine the source of the various receipts categorized by petitioner as "vending machine and other income". Accordingly, the burden was on petitioner not only to show that certain receipts were not subject to tax, but also to establish the amount of those receipts.

Evidence offered by the petitioner to establish the amount of its receipts in each of the areas under consideration consisted almost entirely of Mr. Wexler's sworn testimony. That testimony was based on Mr. Wexler's review of petitioner's books and records, Mr. Wexler's general familiarity with petitioner's accounting methods and procedures, and his conversations with persons employed by petitioner during the audit period. There was no evidence in the record contradicting his testimony, portions of which were supported generally by other evidence in the record. The Division argues that in order to carry its burden of proof it was necessary that petitioner present source documents or other forms of documentation to corroborate Mr. Wexler's testimony. There is no authority for this proposition. "Relevant and probative hearsay evidence is admissable in administrative proceedings; moreover, it may...constitute substantial evidence to support the administrative agency's determination" (Matter of Flanagan v. New York State Tax Commn., ____ AD2d ____, 546 NYS2d 205, 206).

Through the uncontroverted testimony of Mr. Wexler, petitioner established that its receipts from the live peep shows amounted to $87,353.00 and its receipts from the private peep shows amounted $24,568.00. All other receipts in the category denominated by the petitioner as "vending machines and other income" were not taxable. The Division will reduce the tax assessment in accordance with this finding.

H. In accordance with the stipulation executed by the parties, tax assessed for the periods June 1, 1976 through May 31, 1976 and March 1, 1979 through August 31, 1979 is canceled.

I. Petitioner has not established that this audit was conducted for the purpose of harassing petitioner or in any way interfering with its right to conduct its business; therefore its argument regarding selective enforcement of the Tax Law will not be addressed. Petitioner attacked both Tax Law § 1105(f)(1) and 20 NYCRR 528.6(c)(1) on constitutional grounds. Legislative enactments are presumed to be constitutional at the administrative level, and, in light of Conclusion of Law "D", the constitutionality of the regulations defining periodicals need not be considered here.

J. The petition of 1605 Book Center, Inc. is granted to the extent indicated in Conclusions of Law "D", "F, "G" and "H". The Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1976 through August 31, 1979 shall be modified accordingly.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE