To be argued by W. Andrew McCullough
Time Requested: 20 minutes

COURT OF APPEALS
STATE OF NEW YORK

In the Matter of

677 NEW LOUDON CORPORATION, D/B/A/ NITE MOVES,

Index No. 509464

Petitioner and Appellant,

Mo. No. 2011-784

-against-

STATE OF NEW YORK TAX APPEALS TRIBUNAL; and JAMIE WOODWARD, *in his official capacity as Commissioner of the New York State Department of Taxation and Finance,*

Respondents.

REPLY BRIEF FOR PETITIONERS AND APPELLANTS

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POINT I A

PETITIONER'S PRESENTATIONS ARE EXEMPT FROM TAXATION UNDER TAX LAW § 1105(f)(1).

Petitioner has previously acknowledged that a taxpayer has the burden of establishing entitlement to the exemption. This Court has also said, however, in 1605 Book Center v. Tax Appeals Tribunal, 83 N.Y.2d 240, 609 N.Y.S.2d 144, Cert. Denied 513 U.S. 811 (N.Y. 1994) that ambiguities are construed in favor of the taxpayer. The Commissioner does not acknowledge that authority. To the Commissioner, the New York Tax scheme seems to be set up to give a taxpayer an illusion of an exception, without any hope of ever obtaining one. To be sure, the tax scheme is sometimes a bit opaque. The Commissioner, however, takes a jaundiced view of the procedures. If the legislature truly did not want anyone to claim exemptions, they most likely would not create them. The law is not meant to be a trap, but is to be administered fairly. If the law were not already clear enough, the legislature broadened the exemption from the entertainment tax by enacting Tax Law § 1123. The Commissioner says that would not matter, as Petitioner's entertainment does not fit within any exemption, no matter how large. But the Commissioner is wrong that

exemptions are largely illusional. The Commissioner starts out with the false assumption that everything that is not taxed is therefore subsidized by the State. An exemption from taxes is strictly construed because it is "a matter of legislative grace" (St. Br. P. 23). The Commissioner apparently believes that the State taxes all activities except those who fall within its "grace":

> If you drive a car, I'll tax the street,
> If you try to sit, I'll tax your seat,
> If you get too cold, I'll tax the heat,
> If you take a walk, I'll tax your feet.
> (George Harrison)

If the State were to tax everything it could tax, except for those activities worthy of its "grace", it would be a sad world. This Court should give reasonable scope to exemptions, exclusions, or exceptions to specific taxes. Then, if the Legislature really does not want to grant them, it can say so and put an end to it.

On p. 29 of its Brief, the Commissioner refers to the same example of dance entertainment, under 20 N.Y.C.R.R. § 527.10(d)(2) which Plaintiff referred to in its Brief, p. 30. The Commissioner, however, goes on to state:

> All of the listed venues and the phrase "other hall or place of assembly" refer to places that offer general admission to the public for performances viewed by multiple, assembled audience members, rather than one-on-one interactions. (St. Br. 30).

This statement specifically relates to Petitioner's "private dance charges"; which the State says is not an admission to a "hall or place of assembly". The Commissioner simply ignores this Court's clear holding in 1605 Book Center v. Tax Appeals Tribunal, 83 N.Y.2d 240, 245, to the contrary: "The booths are factually not taxably distinguishable from a usual theater except for the element of privacy."

The Commissioner then reiterates that the Tribunal found a "dearth of evidence" as to the choreographed nature of the private dances. That finding completely ignores the testimony of Petitioner's expert , (as did the Tribunal) who has observed hundreds of these dances in well over a hundred venues. The Commissioner suggests that "Dr. Hanna merely speculated" as to the nature of the private dances (St. Br. P. 31). Dr. Hanna, however, based on her vast research, actually testified that the stage and the private dances are two parts of the same overall, integrated performance. (A303).

The Commissioner then tries to support the near-total rejection of the expert testimony by the Tribunal, claiming that the rejection was "rational". The Tribunal, we are reminded, objected to the certainty of the expert's testimony, the fact that the expert did not specifically observe a private dance at this particular venue, and also that the testimony seemed "tailored to fit the statutory exemption." The Tribunal's

rejection was most certainly based on the exact type of argument made earlier in the Commissioner's Brief, that "adult entertainment" is not worthy of "subsidy", and that to grant the exemption would be to endorse "objectionable consequences". (See Point I B below). The Tribunal arbitrarily and capriciously refused to recognize the expert's credentials and experience, including 43 separately listed instances of expert testimony before Courts around the country (A315-391); and literally hundreds of articles, papers and presentations (A269-287). The expert's "certainty" is wholly in line with her expertise. Moreover, it is bolstered by the complete lack of cross-examination or any attempt to impeach or rebut. The objection that the opinion was framed in relation to the questions at issue, is perplexing. Yes, the expert did testify that it was her opinion that the performances fit into the specific exemptions at issue. That was exactly the point. Why did the Division not ask her any questions about her conclusions at the hearing? The only grounds to object now is that her conclusion was not to the Commissioner's liking. These are not valid critiques. The Commissioner suggests that a new dancer without previous dance training cannot be considered choreographed. That State has continually asserted its authority as a dance critic; and that is the basis for the Tribunals decision. That is not the proper role of government; and that is not a power which naturally flows from the directives

of the Legislature. See again Nakatomi Investments, Inc. v. City of Schenectady, 949 F.Supp. 988 (N.D.N.Y.) 1997.

POINT I B

THE STATUTE DOES NOT VALIDLY CONSTITUTE A "SUBSIDY" OF FAVORED SPEECH.

The Commissioner really gets to the point, when she states that "There is no evidence that the Legislature intended to subsidize adult entertainment through this exemption". (p.25). This reflects the decision of the Tribunal in reversing the well-reasoned determination of the ALJ. The Tribunal refused to "subsidize" a form of entertainment that it found personally distasteful. Now the Commissioner makes the argument forcefully:

> when the Legislature intends to address adult entertainment, it has done so explicitly, distinguishing it from other entertainment.
>
> Thus, the fact that the legislature did not explicitly exempt adult entertainment charges in § 1105(f)(1) suggests that they are not exempted." (St. Br. 26).

The argument is that the Legislature would not hesitate to treat adult entertainment differently from all other entertainment, and notes that it has not done so here. The seemingly obvious result is that there is, in this instance, no such different treatment. What the Commissioner's argument comes down to is that Petitioners are not

entitled to fair and reasonable treatment. According to the Commissioner, if the Legislature had intended to treat them fairly, it would have said so. The law will assume otherwise unless that intention is explicit. Such an argument is certainly a bit cynical. The argument of the Commissioner here is that the tax must apply to Petitioner because Petitioner is not the kind of business should be "subsidized". A citation is made to City of Erie v. Paps AM, 529 U.S. 277 (2000), regarding the negative "secondary effects" of adult entertainment. The "secondary effects" argument is one used for zoning purposes. The argument is that certain businesses, wholly apart from the "message" of the entertainment, cause problems with property values and increased crime, by their location. That is not at issue here. The Commissioner does not respond to Petitioner's citation of City of Los Angeles v. Alameda Books, Inc., 535 U.S. 425, 445 (2002) :

> On the other hand, a city may not regulate the secondary effects of speech by suppressing the speech itself. A city may not, for example, impose a content based fee or tax. This is true even if the government attempts to justify the fee by reference to the secondary effects." (Emphasis added).

Justice Kennedy also stated:

> Though the inference may be inexorable that a city could reduce secondary effects by reducing speech, this is not a permissible strategy. The purpose and effect of a zoning ordinance must be to reduce secondary effects and not to reduce speech.

> A zoning measure can be consistent with the First Amendment if it is likely to cause a significant decrease in secondary effects and a trivial decrease in the quantity of speech. Id. At 445. (Emphasis added).

The Commissioner reminds the Court that statutes "are ordinarily interpreted so as to avoid objectionable consequences". This does not appear to comport with the statement of the Appellate Division that:

> Notably, neither the Tribunal's decision nor the underlying statutes preclude an adult juice bar from qualifying for the claimed exemptions under a different set of circumstances, and the record as a whole fails to support petitioner's claim that the relevant fees were taxed for some reason other than the legitimate collection of sales tax revenues. In short, petitioner was denied the requested relief due not to the nature of the business but, rather, because of the inadequacy of its proof. (Emphasis added). (A9-10).

That no longer appears to be the position of the Commissioner.

The Commissioner and the Tribunal have attributed their distaste to the Legislature,; but the Appellate Division apparently missed that legislative statement. If the Legislature had wanted to exempt "dramatic and musical arts performances" from the entertainment tax, but not THIS KIND of dramatic and musical arts performance, it could have said so. All the arguments about choreography, and what constitutes "dramatic or musical arts performances" are seemingly now subsumed in the objections of the Commissioner and the Tribunal to the type of entertainment presented by Petitioner.

The Commissioner cites, for the first time, Stahlbrodt v. Commissioner of Tax. And Fin. Of the State of New York, 92 N.Y.2d 646 (NY 1998), which upheld, against a facial challenge a tax on "shopping papers", which contained more than 90% advertising. This Court found that the exemption for newspapers that included the barest amount of news along with advertising, was indeed a form of subsidization. The newspaper could take advantage of this particular subsidy by simply adding a small amount of local news, as contemplated by the statute. This Court cited to Regan v. Taxation with Representation of Wash., 461 U.S. 540 (1983), where the U.S. Supreme Court found the tax deduction to be:

> a form of [legislative] subsidy administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of the tax it would have to pay on its income." Id. at 544.

The Court went on to say, however, "in stating that exemptions . . . are like cash subsidies . . . we of course do not mean that they are in all respects identical." Id. The Illinois Supreme Court, in Pooh-Bah Enterprises, Inc. v. County of Cook, 905 N.E.2d 781 (Ill. 2009) recently upheld such an exemption from an entertainment tax for certain small venues, but which specifically did not exempt "performances conducted at adult entertainment cabarets". The ordinance at issue contained a lengthy statement of support for "culturally enriching performances". But there are no such statements, nor is there legislative support for what the Tribunal did here.

The Tribunal read into the law a preference which was not there. This, then is not a legislative "subsidy" at all, but one solely in the minds of the Tax Tribunal. The fact is that the term "legislative subsidy" was not even mentioned until the case had been argued on three lower levels. Can we not assume that the intention of the Legislature would not have been buried so deep that it would take so long to find it? This Court previously, in 1605 Book Center, that exotic dancing might be entitled to the theatrical exemption, upon the right proof. Petitioner's dance presentations are substantially more professionally presented than the "peep shows" described in that case. The Legislature could have closed the "loophole" at that time, or when it expanded the entertainment tax exclusion under Tax Law § 1105(f)(3) in 2006. It is one thing to uphold such a distinction by a local government (which may have considered "secondary effects within its territory), and another to read it into a statewide tax statute when it is not there. See Speiser v. Randall, 357 U.S. 513, 518 (1958): "A discriminatory denial of a tax exemption for engaging in speech is a limitation on free speech." And further;

> To deny an exemption to claimants who engage in certain forms of speech is in effect to penalize them for this speech. Its deterrent effect is the same as if the State were to fine them for this speech. The appellees are plainly mistaken in their argument that, because a tax exemption is a "privilege" or "bounty," its denial may not infringe speech. Id.

See also Camps Newfoundland/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 589 (1997): "tax exemptions and subsidies serve similar ends, [but] they differ in important and relevant respects, and our cases have recognized these distinctions". Because the Constitution bars discriminatory treatment, "there is a constitutionally significant difference between subsidies and tax exemption,", and even though "a direct subsidy . . . would be permissible, our cases do not sanction a tax exemption serving similar ends." Id. at 589-590. In Minneapolis Star v. Comm'r of Rev., 460 U.S. 575 (1983) the Court invalidated an exemption for the first $100,000 in paper and ink that treated some newspapers more favorably than others. This principle was extended in Arkansas Writers Project, Inc. v. Ragland, 481 U.S. 425, 429 (1987) to invalidate a sales tax exemption that benefitted religious, trade and sports magazines, among other publications.

Unlike taxes on expression, subsidies lack "the power to destroy." Such differential treatment has always been considered "presumptively unconstitutional" because the complex burdens associated with taxation pose "too great a threat to concerns at the heart of the First Amendment. Minneapolis Star at 589-5.

POINT II

PETITIONER'S ESTABLISHMENT IS NOT SUBJECT TO SALES TAX ON ITS ADMISSIONS AND PRIVATE DANCES; AS IT IS A CABARET OR SIMILAR

VENUE.

The Commissioner argues that, even should Petitioner prevail on the exception to the entertainment tax levied by Tax Law § 1105 (f)(1) "the charges are alternatively taxable under Tax Law § 1105(f)(3)." (St. Br. P. 37). This Court has never ruled on the interaction of these two Tax sections; but the tax levied under Tax Law § 1105 is one tax, and the text makes that clear. If an activity is exempt, it is exempt. That may sometimes require the Division to determine just what provisions to invoke in order to determine what tax treatment to give an activity. Once, however, it is determined that an activity is exempt (or excluded), the question is be closed. The ALJ accepted this argument in her Determination:

> In fact, a more plausible explanation is that one must look to the primary focus of each of the Tax Law sections, and then determine whether the primary focus of petitioners' transactions, occurring in the context of this business venue, results in a taxable event. (A42-43).

The Commissioner argues that Plaintiff's business is a cabaret or other similar place, and so "alternatively" subject to the tax under Tax Law § 1105(f)(3). And, for the first time before the Appellate Division, the State argued that any exemption for "live dramatic or musical arts performances" under this section is hopeless, because that was already decided in the State's favor, in reference to Tax Law § 1105(f)(1). Petitioner, according to the Commissioner, should not get a second bite at the apple (but the State does, and may thus void the exemption under Tax Law §1105(f)(1). It

is important to note that neither the ALJ nor the Tribunal decided on the basis of this argument, which was not made before them. But then the Commissioner seems to ignore the definition of "cabaret", even as she cites it:

> "Roof garden, cabaret or similar place" includes "any room in a hotel, restaurant, hall or other place where music and dancing privileges or any entertainment, are afforded the patrons in connection with the serving or selling of food, refreshment or merchandise". 20 N.Y.C.R.R. § 527.12 (b)(2) (St. Br. P. 37-38).

The emphasis of a cabaret is on the food and refreshment, by definition. That refreshment is likely to include alcoholic beverages. The tax is not levied precisely when the serving of food and refreshment is NOT the emphasis. That only makes sense. Where that emphasis does not exist, it is really not a cabaret at all. The Commissioner wants to call Petitioner's establishment a Cabaret, but then to limit the deduction (or exemption, or exclusion) in such a way that Petitioner can never qualify for it. But the way the State reads the exemption (or exclusion) for "dramatic or musical arts performances" is also flawed. The definition of a cabaret clearly includes places where the patrons themselves have "dancing privileges". And the Commissioner has endorsed the use of the exemption in such places in Advisory Opinion TSB-A- 91. The Commissioner disputes this in a footnote (St. Br. fn. 6), and states that it is "implausible that the legislature intended a single phrase to have

different meanings in different sections." (St. Br. 39). But it is the context that is important. A theater is a different place from a Cabaret. It would make little sense to include this type of place within the definition of "cabaret", and then not allow an exemption, or exclusion., as a place that does not emphasize the sale of food and refreshment. The Commissioner understood that in the Advisory Opinion, even if it is not convenient for her now. The use of the term "dancing privilege" reflects the same kind of place designated in Federal law as "ballroom" or "dance hall". The point is that the less emphasis there is on the service of food and refreshment, and "dancing privileges", the less an establishment resembles a cabaret (and more resembles a theater). That is the only way for the provisions to be read together and to make sense in their contexts. In fact, the Appellate Division referred to Petitioner's argument about an "exemption" in quotes, as if it were an erroneous reference:

> In this regard, although the Tribunal's decision focuses primarily upon whether the club's register sales from the sales of nonalcoholic beverages sold qualify as incidental, implicit in its analysis of Tax Law § 1105(f)(3) - and its corresponding rejection of petitioner's claimed "exemption" thereunder - is a finding that the dances offered at petitioner's club did not constitute "live dramatic or musical arts performances" within the meaning of the statute. Having already found that the Tribunal's resolution of that factual issue was rational, we need not proceed to consider whether petitioner's beverage sales would qualify as incidental. (A9) (Emphasis added).

Despite the fact that the statute as a whole uses the terms "exemption", "exception"

and "exclusion" interchangeably, it is more accurate to look at Tax Law § 1105(f)(3) in terms of its limiting definition. Thus, rather than creating another exemption, to taxable activity, it excludes certain places from the definition of "cabaret". Thus, the exemption need not be strictly construed. The inquiry should be whether Petitioner's business was ever included in the first place; and it makes the most sense to determine that it was not.

Finally, the Commissioner refers to the 2006 enactment of Tax Law § 1123, after the tax period at issue here, and suggests that this section was enacted specifically out of concern that activity exempted from tax under Tax Law § 1105(f)(1) might still be taxable under Tax Law § 1105(f)(3). That was NOT what the legislature intended to accomplish, and the new section was to make this clear. Petitioner implores this Court to fully review the tax scheme before it and to clarify what is to be taxed, and how. This taxpayer is the subject of a new tax audit, DTA #824333, for the audit period of 6/1/2007 to 2/28/2010, now pending before the Division of Tax Appeals. The Division of Taxation denies, in that proceeding, that the new statute grants Petitioner any relief:

> The Division . . . AFFIRMATIVELY STATES that during the period of September 1, 2005 through February 28, 2010, the period in issue petitioner owned and operated a place of business in the State of New York, and the receipts thereof were subject to taxation under § 1105 of the Tax Law. (Answer

to Petitioner's Petition for Redetermination, dated June 22, 2011)

Note that, at least in this instance, the Division treats the tax levied by Tax Law § 1105 as a singular tax, and not as several taxes, levied "in the alternative". It is clearly in the interest of justice to avoid unending litigation on a matter that can and should be settled here.

POINT III

A CONTENT BASED DISCRIMINATORY TAX VIOLATES PETITIONER'S CONSTITUTIONAL RIGHTS.

The Commissioner, in Point II, defends the legislative enactment as "content neutral". This would be more convincing if she had not argued strenuously in her opening pages, that the Tax Law is NOT to be read as "content neutral". Now the Commissioner points out that "other types of performances that do not include adult entertainment, such as variety shows, magic shows and animal acts, also do not qualify for the exemption." (St. Br. 49). But then the Commissioner goes right back to the theme of "secondary effects (Id.). It is not that the a Legislature did not provide for the claimed exemption as alleged with animal acts, it is that Petitioner just is not the kind of place that should be treated fairly. The Commissioner states that "The legislative determination not to extend a sales tax exemption to petitioner's adult entertainment admission charges passes constitutional must under these

principles." The Commissioner utterly fails, however, to set out where and how that "legislative determination" was made. And certainly one must wonder how that legislative determination was totally missed by this Court, and all the lower tribunals in 1605 Book Center. Would that not have put an end to the controversy right there, if this Court simply said: "This type of entertainment was singled out for special treatment by the Legislature"? But nobody suggested that was true there; and the Legislature has not tried to make it any more clear since.

Finally, the Commissioner states that Petitioner did not fully argue its constitutional concerns commending in its initial Petition, including references to the New York Constitution and the "Equal Protection" clause. Clearly, the ALJ was not the forum for such arguments; and Petitioner properly preserved the opportunity to advance the proper Constitutional issues before the proper tribunals. This Court could surely remand for further proceedings if it so chose; but this is the forum for such issues. The arguments concerning unlawful discrimination under both Due Process and Equal Protection have been set out with sufficient clarity for this Court to rule, should those issues be determinative. There is plenty of reason, based on the testimony and the legal support, for a reversal of the Appellate Division decision. Most certainly the Tribunal did act in an arbitrary and capricious manner when it

reversed the determination of the ALJ. Most certainly, there were serious legal errors as well as a lack of "substantial evidence" to support it

CONCLUSION

The decision of the Appellate Division that Petitioner's admissions are subject to taxation under Tax Law §1105 (f)(1), under Tax Law §1105 (f)(3) should be reversed. There are clear exemptions, or exclusions, which apply to this Petitioner; and the sales tax on admissions does not apply to this establishment.

The determination of the Tax Appeals Division that Petitioner's admissions are to a place featuring dramatic or musical arts performances, and are exempt from the sales tax on admission to a place of amusement pursuant to Tax Law §1105(f)(1) should be reinstated. The determination of the Tax Appeals Division that, if Petitioner's establishment is a "cabaret", the sale of beverages is not more than incidental, and thus not within the definition of establishments taxed under Tax Law §1105(f)(3) should also be reinstated. In the alternative, this Court should find that Petitioner's establishment is excluded from the definition of a Cabaret, and thus not subject to that tax.

Further, attorneys fees should be awarded to Petitioners under the Equal

Access to Justice Act.

DATED this ____ day of March, 2012.

W. ANDREW MCCULLOUGH, L.L.C.

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STATE OF UTAH)
) SS:
COUNTY OF SALT LAKE)

W. Andrew McCullough, being first duly sworn, says: I am not a party to the action, am over 18 years of age and reside at: Lehi, Utah. On the ___ day of March, 2011, I served three copies of the foregoing Brief by mailing them in a sealed envelope, with postage prepaid thereon, in a post office, or official depository of the U.S. Postal Service, addressed to the following at their last known address(es) set forth below:

Hon. Eric T. Schneiderman
New York State Attorney General

Robert M. Goldfarb, Esq.
The Capitol
Albany, NY 12224

(Signature) _____

(Print Name) W. Andrew McCullough _____

Sworn to before me this ___ day of _____.

_____
Notary Public