14-4

February 28, 2014

In Re: Mag Enterprises, Inc. 36LSMERZZ9900; 36BPMERZZ8093; 36ATMERZZ9982

Delilah's Den of Philadelphia 36LSMERZZ9901; 36ATMERZZ9984

Conchetta, Inc. 36LSINPZZ9946; 36WMINPZZ9071; 36ATMERZZ9983

Statement of Record:

1. M.A.G. Enterprises, Inc. filed a Petition for Appeal with the Tax Review Board on December 4, 2012 requesting review of assessments by the City of Philadelphia for the Liquor Sales Tax, Business Privilege Tax (now known as the Business Income and Receipts Tax) for the years 2008 and 2010 and the Amusement Tax for the years 2008 through 2010.

2. Delilah's Den of Philadelphia filed a Petition for Appeal with the Tax Review Board on October 11, 2012 requesting review of assessments by the City of Philadelphia for Amusement Tax and Liquor Sales Tax for the years 2008 through 2010.

3. Conchetta, Inc.filed a Petition for Appeal with the Tax Review Board on October 17, 2012 requesting review of an assessment by the City of Philadelphia for Amusement Tax for the years 2008 through 2010 and waiver of interest and penalties accrued against assessments for Liquor Sales tax and Wage Tax.

4. The 3 appeals were consolidated at the request of the parties due to the identical nature of the primary legal issue related to the applicability of the Amusement Tax to certain personal entertainment activities offered within each petitioner's club to individual patrons for a fee.

5. A public hearing was held during the course of 6 sessions of the Tax Review Board in July and August of 2013. At the conclusion of this hearing on August 8, 2013, the matter was taken under advisement by the Tax Review Board.

6. On October 8, 2013, the Tax Review Board announced the following decision:

   M.A.G .Enterprises, Inc.: Liquor Sales Tax and Business Income and Receipts Tax: No action is needed by the Tax Review Board as per the parties' statements that these matters were settled;

   Delilah's Den of Philadelphia, Inc.: Liquor Sales Tax: [illegible] of the penalty is abated contingent on payment of the balance due within 30 days;

Conchetta, Inc.: Liquor Sales Tax and Wage Tax: No action is needed by the Tax Review Board as per the parties' statements that these matters were settled.

As to the Amusement Tax assessments for all 3 Petitioners: The petitions are granted and the assessments abated in total.

7. The City of Philadelphia filed appeals to the Philadelphia Court of Common Pleas.

Introduction:

This case involves separate audit assessments for Amusement Tax issued by the City of Philadelphia Department of Revenue to the 3 petitioners, all of whom own and operate what are commonly known as Gentlemen's Clubs, in the City of Philadelphia. Each petitioner charges an admission fee or cover charge to patrons at the door for entry into the club. Inside the club, patrons may purchase food, drinks, listen to music and watch stage performances by individual entertainers. In addition, each petitioner offers the opportunity to engage the entertainers for personal entertainment within the club, either in the general seating areas or in private or semi-private areas. Separate fees are charged for these personal entertainment opportunities.

The audit assessments under appeal assessed Amusement Tax on the fees and charges collected for the indoor entertainment activities under the theory that these were separate admission fees or charges for engaging in amusement subject to this tax under The Philadelphia Code Chapter 19-600.

The Petitions for Appeal filed by these 3 entities were consolidated for purposes of an evidentiary hearing before the Tax Review Board by agreement of the parties because of the identical nature of the legal issues involved in the appeals.

There were some minor differences in the facts specific to each petitioner. Therefore the facts as determined for each petitioner are set forth below separately.

Findings of Fact:

1. **M.A.G. Enterprises Inc.**
   A. M.A.G. Enterprises, Inc. (hereafter "M.A.G.") does business in Philadelphia as a gentlemen's club under the name Cheerleaders.
   B. The Amusement Tax assessment under appeal was for tax principal of (with interest of , and penalty of as of the petition filing.
   C. Patrons pay an admission fee to enter the club. Amusement Tax is collected and paid to the City based on this admission fee at the front door. There is no dispute by the parties as to the imposition of the Amusement Tax on this admission charge.

D. Inside the club, patrons may view or participate in a variety of activities. They may purchase food, and alcoholic or non-alcoholic drinks, watch stage shows of erotic dancing, and they may choose to purchase private or semi-private personal entertainment with accompanying food and drink at a package price.

E. In addition to cash or credit cards to make purchases within the club, patrons may purchase "Cheerdollars" from the club. These Cheerdollars may be used to make all purchases. They may be used to purchase, food, drinks, for tipping bar or wait staff, or personal entertainment. Some Cheerdollars remain uncashed if a patron does not spend all of his Cheerdollars on a given visit to the club.

F. The club charges patrons a surcharge of for all Cheerdollars and a redemption fee of o entertainers who redeem them for cash.

G. The Amusement Tax was assessed on the surcharge and redemption fees, on Cheerdollars used for tipping, and Cheerdollars used for food and drink purchases unrelated to any personal entertainment activities. The Amusement Tax was assessed on the gross sales for Cheerdollars without any distinctions as to their use.

H. The city auditor admitted under cross-examination that the surcharge and redemption fees and the Cheerdollars used for tipping should not have been assessed for Amusement Tax. See Notes of Testimony 8-6-13, page 56-57.

I. Patrons who want to use their Cheerdollars to purchase personal entertainment pay the entertainers with the Cheerdollars. The entertainers give these Cheerdollars to a security attendant to hold for safekeeping until the end of their shift. At that time the Cheerdollars are divided among the club, the entertainer and the security attendant.

J. The club will use its portion to pay the cost of any food or drink provided to the patrons as part of the personal entertainment packages and will retain the balance as profit. For example, the private entertainment called "Champagne Dances" will cost the patron for 1 hour of personal time with an entertainer. The club retains o cover the cost for food, beverages and its profit. The security attendant receives nd the entertainer receives the remaining

K. The entertainers are considered by the club to be independent contractors. They pay to the club a fee of per day and per shift. The fees charged for personal entertainment are determined by the club operator.

L. M.A.G. was previously audited for the tax years 2002 to 2004. The club was assessed Amusement tax on the admission charges for entry into the club. At some point, M.A.G. was also assessed and remitted Amusement Tax for the percentage of the personal entertainment fees retained by the club.

M. The club maintained records of the fee breakdown and paid the appropriate sales taxes for the liquor and food sales and included its profit in Profit and Loss

Statements and for BIRT purposes. Their Profit and Loss Statements reported the percentage of the personal entertainment fees retained by the club.

2. **Delilah's Den of Philadelphia, Inc.**

A. Delilah's Den, Inc. (hereafter "Delilah's") does business in Philadelphia as a gentlemen's club.

B. The audit assessment under appeal covered the Amusement Tax for the years 2008-2010 and assessed tax principal of with interest of and penalty of as of the petition date. This tax was assessed against the fees paid inside the club by patrons for personal entertainment performance, food and drinks.

C. Patrons who enter Delilah's pay an admission fee on which Amusement Tax is charged by the club owner. This fee provides entrance into the club to attend and engage in activities such as purchasing food and drinks, watching erotic dance performances and purchasing personal entertainment.

D. Amusement Tax is collected and paid to the City based on this admission fee at the front door. There is no dispute by the parties as to the imposition of the Amusement Tax on this admission charge.

E. In addition to cash and credit cards, patrons may purchase "Delilah Dollars" from the club to be used to pay for personal entertainment activities and tips. They cannot be used for food or drink. Delilah's charges the patron a surcharge for the purchase of Delilah Dollars, keeping for the club and giving to the hostess.

F. Delilah's offers personal entertainment in private and semi-private suite areas. A patron pays separate fees for personal entertainment in a suite area. There is a suggested fee for the entertainer and separate charges for food and drinks, or bottle service. The entertainer retains the entire personal entertainment fee and the club retains the money paid for food and alcohol.

G. By way of example as to the personal entertainment package known as a "Champagne Dance" the patron pays the entertainer in Delilah Dollars, the full value of which is retained by the entertainer. The patron is also required to separately purchase a bottle of champagne from the club.

H. As to "lap dances", which do not include or require food or beverage purchases, and for which there is a charge of the entertainer retains of this fee and the remaining goes to the club.

I. Delilah's did not account for any fees paid directly to the entertainers on its Profit & Loss Statements or tax filings. Commissions and bottle fees were entered into Delilah's books, records and tax filings.

N. The club maintained records of the fee breakdown and paid the appropriate sales taxes for the liquor and food sales and included its profit in Profit and Loss Statements and for BIRT purposes.

O. Delilah's was previously audited in 2006 and Amusement Tax was assessed only on the admission fees charged at the door. It was not assessed on any personal entertainment charges.

3. **Conchetta, Inc.**

A. Conchetta, Inc.(hereafter "Conchetta") does business in Philadelphia as a gentlemen's club under the name Club Risque.

B. Conchetta filed a Petition for Appeal for Wage Tax for years 2008 to 2010, and for Amusement Tax for years 2008 to 2010. Petitioner conceded the Wage Tax principal and asked the TRB to consider only abatement of accrued penalty.

C. There was a prior audit in 2006 for years 2002 to 2004. At that time, Conchetta was assessed and paid Amusement Tax only on the admission fees collected to enter the club. At that time, they were instructed by the auditor to continue to pay the tax on this entrance fee and complied.

D. The subsequent audit, the subject of this appeal resulted in an Amusement Tax assessment of principal, plus interest of ,and penalty of as of the petition date. This tax was assessed against the fees paid inside the club by patrons for personal entertainment activities, food and drinks.

E. Patrons who enter Club Risque pay an admission fee on which Amusement Tax is charged by the club owner. This fee provides entrance into the club to attend and engage in activities such as purchasing food and drinks watching erotic dance performances and purchasing personal entertainment.

F. There is no dispute by the parties as to the imposition of the Amusement Tax on this admission charge.

G. Patrons can also engage the entertainers for personal entertainment known as "lap dances" for which there is a fee. The charges for the personal entertainment are paid to the entertainers directly by the patrons. The entertainers then hand the money for safekeeping to a security attendant hired by the club. At the end of her work shift, the entertainer takes her share of the fee from the attendant and the club takes its share of the fee that covers the cost of any food and alcohol provided to the patron as part of the personal entertainment and then the club's profit is the remainder. For example, for a lap dance the entertainer keeps and the club keeps the remaining For a "Champagne Dance", the fee is divided for the cost

of liquor and food, the fee for the entertainer and the balance retained by the club.

H. The bill under appeal assesses Amusement Tax on the entire fee with no allowances or deductions for food or liquor costs and no distinctions made between the amounts retained by the entertainer and the amounts retained by the club.

I. The club maintained records of the fee breakdown and paid the appropriate sales taxes for the liquor and food sales and included its profit in profit and loss statements and for BIRT purposes. Their Profit and Loss Statements reported the percentage of the personal entertainment fees retained by the club.

4. It was the testimony of the auditor, Roby Mathews, that he assessed Amusement Tax on of the personal entertainment charges after showing of these charges as income.
5. Delilah's was assessed Amusement Tax only on those personal entertainment charges not attributable to food and liquor sales.
6. Conchetta and M.A.G. were assessed on of the personal entertainment charges. Mr. Mathews testified that he did not know at the audit that a portion of these personal entertainment charges are allocated to food and alcohol, and in the case of Cheerleaders, that the Cheerdollars can be used for tipping and purchases unrelated to the personal entertainment activities.
7. The audit work sheets for M.A.G. and Conchetta state that the Amusement Tax is to be assessed on "entertainment income". See Conchetta Exhibit Binder, Exhibits 28 &29.

Conclusions of Law:

1.All but the Amusement Tax and one interest and penalty matter were settled by the parties prior to the Tax Review Board hearing. Therefore the subject of the TRB decision was primarily directed to the Amusement Tax assessment on the revenue from fees collected for personal entertainment activities within Petitioners' clubs.

The main issue argued was whether the Amusement Tax could be applied to the amounts charged to patrons for private entertainment activities, known as "lap dances".

It was the position of the petitioners that the Amusement Tax ordinance covered only the admission charge collected at the door for entry into the club and did not encompass charges for personal entertainment activities occurring within the clubs. The city's position was that the

ordinance was to be broadly construed to also be assessed against fees charged once inside the clubs to patrons who purchased additional personal entertainment services.

The issue presented to the TRB was whether charges or fees assessed by a producer to its patrons for personal entertainment activities within its venue fall within the purview of the Amusement Tax.

It was the finding of the TRB that the Amusement Tax ordinance in The Philadelphia Code Chapter 19-600 contains unclear directives and definitions as to what this tax is meant to cover thus necessitating a finding in favor of the petitioners. It is well settled that when a taxing statute is vague or unclear, any doubts about its application are to be construed in the light most favorable to the taxpayer. *Township of Derry v. Swartz,* 21 Pa. Cmwlth 587, 590 (1975

The facts for each club varied slightly but the common theme was that the Philadelphia Department of Revenue (Revenue) assessed Amusement Tax on the full fee amounts charged to patrons who engaged individual entertainers for personal entertainment, known as Champagne Dances and Lap dances, within the club. These charges were separate and in addition to any cover or admission charges for entry into the clubs. These personal entertainment fees frequently included food and drink charges as well as the individual attention of an entertainer.

The Amusement Tax assessment under appeal was levied pursuant to The Philadelphia Code Chapter 19-600 et seq. It is assessed on the "established price charged to the general public or a limited or selected group thereof, by any producer of an amusement."

The Philadelphia Code Chapter 19-601(1)(a) lists certain amusements which may be subject to this tax "where a charge, donation, contribution or monetary charge of any character is made for **admission**." to the amusement. (emphasis added)

This chapter of The Philadelphia Code continues in sections 19-601(1)(b) & (d) to use different language and state the tax is on the "established price" to "**attend or engage in** any amusement". (emphasis added) There is no explanation for how this is to be interpreted when read with §19-601(1)(a). Is attending or engaging in an amusement different than gaining admission to an amusement? There is no indication in the ordinance as to whether the terms in §§19-601(1)(b) and (d) are meant to be read as synonyms for the term "admission" used in§19-601(1)(a) or are meant to expand from that term.

Where a statute does not provide definitions specific to interpreting its intent, the generally accepted usage or plain meaning of the term is to be used. A basic rule of statutory construction is to first look at the words of the statute and apply their usual and ordinary meanings. In this instance, the plain meaning of "attending" an amusement seems clear, but what does it mean to

"engage in" an amusement? And is paying to "attend or engage in" an amusement meant to be different than paying for "admission" to an amusement?

To add to the lack of clarity, to this day, the City's own web site explanation of the Amusement Tax states "(t)his tax is imposed on the **admission fee charged for attending** any amusement in Philadelphia. (emphasis added) Included are concerts, movies, athletic contests, night clubs and convention shows for which admission is charged." This can be viewed at: http://www.phila.gov/Revenue/businesses/taxes/Pages/AmusementTax.aspx

The ordinance does not provide sufficient guidance to taxpayers as to which amusement transactions, if any, beyond the admission price at the door are subject to the City's Amusement Tax.

In the 2006 audits, Amusement Tax was assessed only on the admission fees charged at the door for entry into the clubs for Delilah's and Conchetta; but for the third club, M.A.G., Amusement Tax was assessed on the percentage of the personal entertainer charges retained by the club. By the time they arrived at the 2012 audits, the City retroactively assessed Amusement Tax on the entire personal entertainment fee for M.A.G. and Conchetta; but allowed Delilah's to deduct the food and beverage costs. This provided a clear demonstration that even the city auditors had differing opinions as to the scope of the tax.

All 3 clubs charge an admission fee at the door and all 3 clubs pay Amusement Tax on that fee. The personal entertainment activities do not require club patrons to enter separate and distinct facilities but take place in all club areas be they public or semi-private VIP seating areas. These entertainment fees are not for admission to private seating in a VIP area or to enter a separate part of the club but for a personal, one on one experience with an entertainer and may include certain food and beverages as part of an entertainment package.

If one assumes this tax is levied on amusements as they are defined in §19-601(1)(a) as "a performance where a charge is made for admission" there is no "admission" fee in the generally understood sense of the word for a lap dance or other personal entertainment activity which a customer might choose when inside one of the clubs and for which the customer pays a separate charge. Activities occur throughout the clubs and do not require entry or re-entry into specific venues different than the venue for which the original entrance or admission fee was paid. Patrons are paying an activity or service fee, with a component for food and beverages, not an admission fee.

In addition, the tax is limited to the "established price" received by "producers". "Producers" are defined in the ordinance as "any person conducting any place of amusement". The Philadelphia Code Chapter 19-601(1)(d). It seems clear that this definition applies to the club owners, the

petitioners herein. But the tax was assessed even on those personal entertainment fees that went directly to the entertainers who, although acting as independent contractors, were not shown to be "producers" conducting a place of amusement. At no time did the City argue that the entertainers were producers under the ordinance, in need of individual Amusement Licenses under The Philadelphia Code Chapter 19-602 and therefore perhaps required to collect Amusement Tax for their personal entertainment activities.

Adding to the confusion were the City's own prior and inconsistent audits of these same taxpayers, just a few years earlier. Amusement Tax was not assessed at all on this same type of personal entertainment charge in the clubs owned by Delilah's and Conchetta, although the same types of personal entertainment activities and charges existed during that audit period as they do now. Yet for M.A.G., Amusement Tax was assessed on the percentage of the personal activity charge retained by the club.

The 2012 audit assessments were different and differently inconsistent in how the tax was applied to these taxpayers. The assessment for Delilah's allowed deductions from the personal entertainment package receipts for food and liquor sales. The audits for M.A.G. and Conchetta made no attempt to separate the personal entertainment revenue into its various categories of food, alcohol, entertainer fees, club receipts, etc. and then apply the relevant or appropriate taxes to each category. The tax was assessed on of the personal activity charges for M.A.G. and Conchetta. There were no distinctions as to how these fees are paid or how they are apportioned for the entertainers, any security attendants, food, drinks and the club owners for 2 of the taxpayers while making allowances for the third club.

In some instances, the club retained none of the personal entertainment fee and charged separately for food and drink. Yet the Amusement Tax was assessed in full against the club owner for the entertainment, food and drink charges.

In the assessment of M.A.G., Amusement Tax was assessed on the gross sales of Cheerdollars although they can be spent within the club for food or drinks, tipping the staff, etc., completely separate from any personal entertainment, and clearly not subject to the Amusement Tax.

The TRB decision that the ordinance lacks sufficient clarity is bolstered by the fact that the prior City auditors in 2006 limited the assessments for the Amusement Tax to the admission fees charged for entry into the clubs for both Delilah's and Conchetta. Both the City and Petitioners agreed that the same personal entertainment activities with the same types of fees had been present during the 2006 audits with no Amusement Tax assessment for these personal entertainment charges. The only conclusion one is left to arrive at is that these auditors in 2006 did not believe that the Amusement Tax was applicable to the personal entertainment fees.

If the Revenue auditors have varying understandings of what is meant to be taxed under this ordinance, taxpayers cannot be expected to know with surety what revenue is subject to Amusement Tax. This confusion within the City is again reinforced by its own web site explanation with its description of the Amusement Tax as an "admission tax".

2. It was the finding of the TRB that even if this new and expanded application of what is covered by the Amusement Tax were to be a correct interpretation, the City is estopped from retroactively applying it to Petitioners, as these taxpayers were acting in reliance on the City's own Amusement Tax interpretation as stated in the 2006 audit process. The doctrine of estoppel prevents the City from this retroactive application of a new interpretation of the Amusement Tax in direct contradiction to its own prior pronouncements to these petitioners as to which transactions the tax is to be applied.

These specific petitioners could not have been expected to accurately determine that in a 2012 audit the scope of the Amusement Tax would be other than that required by the auditors during the 2006 audits.

No changes or amendments to The Philadelphia Code had been enacted between 2006 and 2010. There had been no new regulations promulgated between 2006 and 2010. There was no notice of any change in interpretation of the ordinance to these taxpayers.

The City then went on to use this new and expanded interpretation for a retroactive assessment complete with interest and penalties as though the taxpayers were somehow at fault or had exercised bad faith by not foreseeing this evolution in the City's application of the ordinance.

These petitioners followed the instructions given to them by the City's auditors in 2006 as to how the Amusement Tax should be applied to their receipts. The city's decision to expand its interpretation of a taxing ordinance without notice should not be given retroactive application. And the taxpayers should not be penalized for relying on the City's Revenue Department determination of how this tax should be applied to their activities.

Concurred:
Nancy Kammerdeiner, Chair
Christian DiCicco, Esq.
Joseph Ferla
George Mathew, CPA