

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petitions :  
of :  
**CAPITAL ONE CONSTRUCTION, INC.** : DECISION  
**AND** : DTA NOS. 825142  
**SHUAI YIN** : AND 825208  
for Revision of Determinations or for Refund of :  
Sales and Use Taxes under Articles 28 and 29 of :  
the Tax Law for the Period March 1, 2004 through :  
February 28, 2010. :

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Petitioners, Capital One Construction, Inc., and Shuai Yin, filed an exception to the determination of the Administrative Law Judge issued on October 16, 2014. Petitioners appeared by Sales Tax Defense, LLC (Mark Stone, CPA). The Division of Taxation appeared by Amanda Hiller, Esq., (Leo Gabovich).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition to the exception. Petitioners filed a brief in reply. Oral argument was heard on August 13, 2015 in New York, New York, which date began the six-month period for the issuance of this decision.

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

***ISSUES***

I. Whether petitioners have established that the audit methodologies utilized by the Division of Taxation were not reasonably calculated to reflect the correct amount of tax due,

or that there were errors made in the application of such audit methodologies.

II. Whether petitioners have established any bases justifying reduction or cancelation of the penalties assessed.

### ***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

1. Petitioner Capital One Construction, Inc. (Capital One) is a general contractor engaged in the construction of commercial and residential buildings. Petitioner Shuai Yin is the sole owner and president of Capital One.

2. On May 5, 2010, the Division of Taxation (Division) mailed a letter to the corporate petitioner scheduling a field audit pertaining to Capital One's sales and use tax liability for the period March 1, 2004 through February 28, 2010. The audit was to commence with a May 19, 2010 field visit to Capital One's offices by the Division's auditor.

3. The Division's May 5, 2010 audit appointment letter states that "[y]ou must show **all** of your sales and use tax books and records to the auditor." Accompanying this audit appointment letter was a list of records required for sales and use tax audits, further specifying the records required to be made available for review. This list included, among other items, sales tax returns, worksheets, canceled checks showing taxes paid, federal income tax returns, New York State corporation tax returns, general ledger, general journal and closing entries, sales invoices, exemption documents supporting nontaxable sales (e.g., resale, exempt use, exempt organization and capital improvement certificates), chart of accounts, fixed asset purchase and sale invoices, expense purchase invoices, merchandise purchase invoices, bank statements,

cancelled checks and deposit slips, cash receipts journal, cash disbursements journal, depreciation schedules, lease contracts, and job cost sheets.

4. The auditor's interview of Mr. Yin and her review of Capital One's books and records revealed that Capital One was not registered as a vendor for sales and use tax purposes and that no sales and use tax returns had been filed during the audit period. Further, Capital One had no general ledger for the portion of the audit period spanning March 1, 2004 through September 13, 2007. In addition, complete sales and purchase invoices were not available for the entire audit period, and many of the invoices that were available were inconsistent with the transaction entries in the general ledger. In view of these facts, the auditor determined Capital One's records to be inadequate for purposes of conducting a direct and detailed audit based thereon, thus entitling resort to indirect audit methodologies including the use of test periods and projections therefrom.

5. The audit of Capital One's business activities addressed three areas, to wit, sales, fixed asset acquisitions, and expense purchases. First, the auditor reviewed Capital One's existing sales records for the test months of March, July and October 2008. Based upon this review, the auditor concluded that the construction jobs performed by Capital One qualified as capital improvements to real property such that its gross sales were not subject to sales tax.

6. The auditor next examined Capital One's fixed asset acquisitions for the entire audit period by reference to its federal income tax returns (including depreciation schedules) and its general ledger for periods after September 13, 2007. This review resulted in a finding of tax due in the amount of \$6,726.49 based on two fixed asset acquisitions, as follows:

- a) Capital One's federal income tax return for 2006 showed the acquisition and placement in service of "transportation equipment" in the amount of \$35,000.00.

The auditor was advised that this item represented the purchase of a Mercedes automobile that was shipped directly to China and was not used in New York State. No purchase invoice or contract was furnished with respect to this acquisition and no documentation, including shipping records, was furnished to establish that tax had been paid or that the purchased item was otherwise not subject to tax. Accordingly, the auditor calculated tax due in the amount of \$2,931.25 on this acquisition.

b) Capital One's federal income tax returns for 2008 and 2009, its general ledger for 2008, 2009 and 2010, and a contract of sale revealed the acquisition of "equipment" from CNH Capital in the amount of \$77,000.00 (including a \$7,700.00 down payment per contract that was not reflected in Capital One's general ledger). The auditor was advised that this item represented the purchase of an excavator from an out-of-state (Pennsylvania) vendor, to be paid for over a period of 48 months. No documentation was furnished to establish that tax had been paid on this acquisition. Accordingly, the auditor reduced the purchase price (\$77,000.00) by the down payment amount (\$7,700.00) to arrive at (\$69,300.00). The auditor then added "listed taxable expenses related to the sale" (\$992.50), to arrive at the total taxable amount due and payable over 48 months (\$70,292.50) commencing as of March 2008. The auditor divided this total amount by the 48 months in the payment period to arrive at the monthly taxable payment amount (\$1,464.43).<sup>1</sup> Based on the foregoing, the auditor computed the total of the taxable payments falling within the audit period (\$20,879.87 for 2008, \$19,037.59 for 2009 and \$1,464.43 for 2010)<sup>2</sup> and, in turn, the resulting tax due thereon (\$1,748.69 for 2008, \$1,916.58 for 2009 and \$129.97 for 2010), thus arriving at total tax due of \$3,795.24.<sup>3</sup>

7. The auditor next examined Capital One's expense purchases based upon its cost of goods sold accounts, using Capital One's general ledger and federal income tax returns for certain test periods. Specifically, the auditor reviewed five categories of expense purchases, consisting of Construction Material Costs (examined for the month of March 2008), and

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<sup>1</sup> The \$70,292.50 total taxable amount due and payable over 48 months does not include the taxable down payment amount (\$7,700.00). In addition, the resulting monthly payment amount (\$1,464.43) represents principal (i.e., selling price) only and does not include the contract interest amount due with each monthly payment, since such interest is not subject to tax.

<sup>2</sup> The taxable amount for 2008 (\$20,879.87) includes the \$7,700.00 down payment together with the nine taxable monthly payments made in 2008.

<sup>3</sup> In calculating the tax due, the auditor applied the tax rate in effect during the particular months, thus accounting for a change in the tax rate (from 8.375% to 8.875%) that occurred during the audit period.

Equipment Rentals for Jobs, Other Construction Materials Costs, Subcontractor Expenses, and Tool and Small Equipment Purchases (examined for the period March 2008 through May 2008).

The auditor's conclusions from this review follow:

- a) Construction Materials Costs: Purchases listed for the month of March 2008 totaling \$92,712.18 from 10 different suppliers, out of total purchases of \$348,519.11, were not supported by any documentation (including invoices) establishing that tax had been paid in full or was otherwise not due.<sup>4</sup>
- b) Equipment Rentals for Jobs: Purchases listed for the months of March through May 2008 totaling \$2,806.00 from two vendors (US Gates [\$206.00] and G.T. Rentals Corp. [\$2,600.00]), out of total purchases of \$11,710.48, were not supported by documentation that tax had been paid or was otherwise not due.
- c) Other Construction Costs: Two purchases listed for the months of March through May 2008 totaling \$70,000.00 from First Star Art (in the amounts of \$40,000.00 and \$30,000.00, respectively), out of total purchases of \$172,467.32, were not supported by documentation to explain either the nature of the purchases or support that tax had been paid or was otherwise not due.
- d) Subcontractor Expenses: Purchases listed for the months of March through May 2008 totaling \$191,170.00 from two subcontractors (four separate listed purchases in the individual amounts of \$80,000.00, \$20,000.00, \$50,000.00 and \$40,000.00 from USA Auto Group, and one purchase in the amount of \$1,170.00 from 609-4618 30 Rd), out of total purchases of \$332,897.00, were not supported by documentation to explain either the nature of the purchases or support that tax had been paid or was otherwise not due.
- e) Tools and Small Equipment: The auditor found no errors in her examination of total purchases of \$4,288.08 listed for the months of March through May 2008.

8. The auditor treated the items in the Subcontractor Expenses account as nonrecurring expenses. As a consequence, she did not include the dollar amount of such items (\$191,170.00) in developing her error rate, but rather simply computed tax due on these items to be assessed as

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<sup>4</sup> The suppliers were Grand Electric Equipment, Lightology, Accutech, Crpress, On Time Concrete, Universal Ready Mix, Inc., T.W. Smith Corp., Maya's Pumping Concrete Corp., Landmark Footwear and Time Marble and Granite. The two examined transactions with On Time Concrete reflect that tax was paid on only part of the invoice amount, the impact of which was to reduce the amount of purchases for which tax had not been paid from \$92,712.18 to \$92,340.45.

a separate amount (\$16,010.49). This treatment resulted in the calculation of a lower error rate and, consequently, a lower amount of tax ultimately assessed via error rate projection.

9. In contrast, and with respect to the Construction Materials, Equipment Rentals for Jobs, and Other Construction Costs accounts, the auditor treated the items therein as recurring expenses. The auditor totaled the amounts of the transactions in each such account for which there was no proof that tax had been paid or was otherwise not due (\$92,340.45, \$2,806.00 and \$70,000.00, respectively). This total (\$165,146.45), denominated “total exceptions,” was compared to the total cost of goods sold amounts in the accounts reviewed for the test months (\$702,335.09), resulting in an error rate of 23.5139%.<sup>5</sup> In turn, the auditor applied the foregoing error rate to Capital One’s total cost of goods sold (expense purchases) for the audit period, as reported on its filed federal income tax returns for the years 2004 through 2009 and as set forth in its general ledger for the months of January and February 2010.<sup>6</sup> By this process, the auditor calculated purchases subject to tax (\$5,124,700.87), and computed tax due thereon in the amount of \$434,285.25.

10. The auditor added tax determined due on fixed asset acquisitions (\$6,726.49 [*see* finding of fact 6]), tax determined due on Subcontractor Expenses (\$16,101.49 [*see* finding of

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<sup>5</sup> The total cost of goods sold amounts reviewed for the chosen test months consisted of Construction Materials (\$348,519.11), Equipment Rentals for Jobs (\$11,710.48), Other Construction Costs (\$172,467.32) Subcontractors Expense (\$141,727.00), Tools and Small Equipment (\$4,288.08) and Worker’s Compensation (\$23,624.00). The Subcontractor Expenses Amount (\$141,727.00) represents the difference between the amount of costs reviewed in that account (\$332,897.00) less the exceptions therein (\$191,170.00) that were assessed as a separate and nonrecurring amount.

<sup>6</sup> The auditor used Capital One’s federal returns for all but the final two months of the audit period because there were no general ledgers for the earlier years of the audit period (*see* finding of fact 4) and because the postings in the general ledgers for later years were inconsistent. The general ledger amounts were used for the final two months of the audit period because there was not, at the time of the audit, a filed federal tax return for the year 2010.

fact 8]) and tax determined due on expense purchases (\$434,285.25 [*see* finding of fact 9]) to arrive at total tax due in the amount of \$457,022.23.

11. On June 27, 2011, the Division issued to petitioner Capital One Construction, Inc., a notice of determination (L-03629807-3) based on the foregoing audit and assessing additional tax due for the period March 1, 2004 through February 28, 2010 in the amount of \$457,022.23, plus interest and penalties. The auditor noted that penalties were imposed based upon the failure to file returns, the failure to provide adequate records for audit, and because of underreporting of tax due by more than 25%. On June 28, 2011, the Division issued to petitioner Shuai Yin a notice of determination (L-036304796-3), assessing the same amounts of tax, interest and penalties upon the premise that Mr. Yin was a person responsible to collect, account for and remit taxes on behalf of Capital One. The auditor noted that Mr. Shin prepared a responsible person questionnaire as part of the audit process indicating that he was the sole shareholder of the corporate petitioner, held the title of president of Capital One, was authorized to sign documents, including tax returns and checks on its behalf, and did so, and that he had and exercised full authority in the operation of Capital One's business activities. This information is consistent with information set forth on the corporate tax returns, as filed, and with the balance of information supplied by Mr. Yin during the course of the audit and at the hearing.

12. Before the Administrative Law Judge, petitioners did not claim that Capital One maintained complete or adequate records, as required, and did not challenge the Division's resort to indirect auditing methods in view of such record-keeping inadequacies. Instead, petitioners raised a number of general challenges to the auditor's conclusions, and submitted some evidence in connection therewith. First, petitioners challenged the auditor's methods and conclusions regarding fixed assets based upon the following:

a) With respect to the transaction described in finding of fact 6 (a) involving the purchase and alleged export of an automobile, petitioners provided a letter dated March 13, 2012 from one Gao Xuemin, the owner of Motor One, Inc., an entity that was closed in January 2012. Mr. Xuemin's letter states that Mr. Yin "bought a 2003 Benz S500 in Feb. 2006 from the auction place in NJ and paid us \$35,000, in full. Also the car was shipped to China the following week after the transaction, and never use[d] in NY area." No other documents, such as a purchase or sale invoice pertaining to the vehicle or shipping documents to support its export to China, were provided with this letter or otherwise.

b) With respect to the transaction described in finding of fact 6 (b) involving the purchase of an excavator, petitioners maintained that the out-of-state vendor but not the purchaser, Capital One, is responsible for the payment of tax due on this purchase. Petitioners also argued, at the hearing, that tax was imposed upon the interest included in the monthly payments and, by brief, that the amount of tax assessed is incorrect since the auditor did not account for a change in the tax rate during the payment period. No additional argument or evidence was provided concerning this item.

13. With respect to the audit results based upon expense purchases, petitioners submitted a group of various invoices in no particular order. Some of these invoices are largely illegible, some are written partly in Chinese, some are unidentified, some are labeled "guest checks" and allegedly represent cash payments for meals and other purchases, some appear to represent gas purchases, a few appear to represent tool rentals or purchases, and some are one sentence "cash payment receipts" that do not identify any particular items or services purchased. Many of the invoices are for even dollar amounts and most do not show the payment of tax in any manner.

14. Petitioners also claimed before the Administrative Law Judge that certain payments, under the category Subcontractor Expenses, represented nontaxable purchases of auto parts from USA Auto Group for resale in connection with an auto parts business Mr. Yin intended to open. In response to this claim concerning the purchase of auto parts, the auditor noted that since Capital One was not registered as a vendor, it was not entitled to issue resale certificates concerning its purchases. The auditor also contacted USA Auto Group for verification

concerning the alleged auto parts purchases and was advised that USA Auto Group sells vehicles but does not sell auto parts, had made no sales to Capital One, and that the invoices purporting to be from USA Auto Group were fictitious. When advised of this information, Mr. Yin admitted that the USA Auto Group invoices were false invoices that had been created by Capital One's former bookkeeper, and that these amounts represented "cash exchanges." Mr. Yin also admitted that while he intended to open an auto parts business, he was not able to do so.

### ***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

The Administrative Law Judge first reviewed the statutes and regulations regarding the imposition of sales tax, including a taxpayer's responsibility to maintain accurate records, and the presumption of taxability (Tax Law §§ 1105 [a]; 1101 [b] [4] [i]; 1110 [a]; 1132 [c]; 1135 [a]; 1138 [a] [1]; 20 NYCRR 321.1 [a]; 532.4 [b] [1], [2]; 533.2 [b]). He noted that when a taxpayer fails to maintain complete records, the Division may estimate the taxpayer's sales tax liability using any method reasonably calculated to reflect the tax due (*Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003).

Turning to the record, the Administrative Law Judge found that Capital One not only failed to file returns for the six years at issue, but also failed to maintain records to substantiate the tax due (Tax Law § 1138 [a] [1]). As such, he concluded that the Division had the right to estimate the amount of tax due in its audit of Capital One. The Administrative Law Judge found that petitioners' challenges to the audit lacked evidentiary support. Specifically, he found that the record lacked evidence supporting petitioners' argument that the Mercedes automobile, listed as transportation equipment, was not used in New York. He also found that the record did not support petitioners' claim that certain items listed as sales were actually "cash exchanges," whereby certain vendors cashed checks as a courtesy, enabling Capital One to have cash on hand

to pay certain expenses. Additionally, he found insufficient support for petitioners' contention that certain auto parts purchases made by petitioner were purchases for resale. The Administrative Law Judge also rejected as unsubstantiated petitioners' claim that the Division improperly asserted tax due on the purchase of an excavator, as well as a claim that sales tax was included in the purchase price of certain items. Accordingly, the Administrative Law Judge determined that petitioners did not establish any error in either the audit method or results.

The Administrative Law Judge also determined that petitioner Shuai Yin was liable for the tax determined due herein as a person required to collect tax under Tax Law §§ 1131 (1) and 1133 (a).

Turning to penalties, the Administrative Law Judge observed that the taxpayer bears the burden of establishing that its actions were based on reasonable cause and not willful neglect (*see Matter of Philip Morris*, Tax Appeals Tribunal, April 29, 1993). Here, he determined that petitioners failed to establish that their failure to file was due to reasonable cause and not willful neglect. As such, the Administrative Law Judge sustained the notices of determination in their entirety.

#### ***ARGUMENTS ON EXCEPTION***

On exception, petitioners continue to argue that the Administrative Law Judge erred in accepting certain portions of the audit. As they did below, they contend that it was an error to charge use tax on the Mercedes because it was shipped directly to China and not used in New York State. Petitioners also continue to argue that certain purchases included sales tax in the purchase price; that certain cash purchases were, in reality, nontaxable cash exchanges; and that certain auto parts purchases made by petitioner were purchases for resale.

Petitioners also raise new points of contention with the audit on exception. They assert that certain purchases were for capital improvement work and were therefore nontaxable. They also assert that certain expenditures were for nontaxable equipment deposits. They further contend that certain invoices are dated outside the test period and therefore should not have been included in the test period. Petitioners also contend that the Division made a tax rate error in its calculation of tax due on the excavator. Petitioners also seek abatement of penalties imposed herein.

Other than the adjustments noted below, the Division asserts that petitioners have failed to establish any errors in the audit. The Division further contends that penalties are properly imposed in this matter.

In its brief in opposition, the Division concedes the following adjustments to the audit:

A. The Division concedes that the auditor committed a mathematical error in calculating the tax due on the excavator purchase (*see* findings of fact 6 [b] and 12). The tax rate should be lowered from 10.067% to 8.375% for the period June 1, 2005 through July 31, 2008 and to 8.875 for the period August 1, 2009 through February 28, 2010, reducing the tax due on fixed assets by \$278.26. Accordingly, the Division concedes that the revised tax due on the excavator is \$1,638.33.

B. The Division concedes that tax was erroneously imposed upon a \$150.00 tank deposit from U.S. Gates (*see* finding of fact 7 [b]). Accordingly, the Division concedes that the tax due for this period should be revised from \$2,806.00 to \$2,656.00.

***OPINION***

Upon review of the record, we find that the Administrative Law Judge's determination fully and correctly addressed all issues presented to him. Accordingly, we affirm the determination for the reasons stated therein.

With respect to the issues raised on exception, we find no evidence in the record to support petitioners' contentions beyond the revisions conceded by the Division in its brief.

Specifically, we find that the record does not substantiate petitioners' claim that certain expenditures were capital improvements. Additionally, other than the above-noted adjustment, we find no substantiation of nontaxable equipment deposits. With respect to the invoices dated outside the test period but included in the test period, our review of the record indicates that such purchases were recorded by Capital One within the test period. Accordingly, no adjustment is warranted.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Capital One Construction, Inc. and Shuai Yin is granted to the extent of the adjustments conceded by the Division as noted above, but is, in all other respects, denied;
2. The determination of the Administrative Law Judge is modified to the extent noted in paragraph 1 above, but is, in all other respects, affirmed;
3. The petitions of Capital One Construction, Inc. and Shuai Yin are granted to the extent noted in paragraph 1 above, but are, in all other respect, denied; and

4. The notices of determination issued to Capital One Construction, Inc. and Shuai Yin, dated June 27, 2011 and June 28, 2011, respectively, modified to the extent noted in paragraph 1 above, are sustained.

DATED: Albany, New York  
February 16, 2016

/s/ Roberta Moseley Nero  
Roberta Moseley Nero  
President

/s/ Charles H. Nesbitt  
Charles H. Nesbitt  
Commissioner  
By BAV with permission

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