

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
JONES DARKWA : DETERMINATION
 : DTA NO. 826171
for Redetermination of a Deficiency or for Refund of New :
York State Personal Income Tax under Article 22 of the :
Tax Law and New York City Personal Income Tax under :
the Administrative Code of the City of New York for the :
Year 2011. :

Petitioner, Jones Darkwa, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City personal income tax under the Administrative Code of the City of New York for the year 2011.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, in New York, New York, on April 17, 2015, at 10:30 A.M., with all briefs to be submitted by August 31, 2015, upon which date commenced the six-month period for the issuance of a determination in this matter. In accordance with Tax Law § 2010 (3), for good cause shown, the due date was extended an additional three months upon notice to the parties. Petitioner appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Leo Gabovich).

ISSUES

I. Whether the Division of Taxation properly disallowed petitioner's claimed earned income credit for the year 2011 on the grounds that he failed to substantiate the earned income he reported for that year on federal Schedule C.

II. Whether the Division of Taxation properly disallowed petitioner's claimed child and dependent care credit for the year 2011 on the grounds that he failed to substantiate the earned income he reported for that year on federal Schedule C.

FINDINGS OF FACT

1. Petitioner, Jones Darkwa, was a self-employed contractor and handyman in New York City during the year 2011. His business included bathroom renovations, painting, sheet rock work and smaller home repairs. Petitioner was registered with the City of New York, Department of Consumer Affairs, as a home improvement contractor, and petitioner presented into evidence valid licenses covering the year in question.

2. Petitioner filed a New York State Resident Income Tax Return (Form IT-201), for 2011, under a head of household filing status. Petitioner has two daughters who lived with him during 2011: Janet Darkwa, born September 7, 2002, and Kayla Darkwa, born October 31, 2010. The Division of Taxation (Division) does not contest the relationship of petitioner's daughters to him, nor their residency, as those qualifications pertain to the tax credits at issue herein.

3. Petitioner's Form IT-201 for 2011, as filed, claimed the following payments and credits: New York State and New York City earned income credits in the amounts of \$1,444.00 and \$256.00, respectively, for a total of \$1,700.00; New York State and New York City dependent care credit in the amount of \$3,296.00; the Empire State child credit in the amount of \$326.00; and the New York City school tax credit in the amount of \$63.00.

4. Petitioner reported W-2 wage income for 2011 from two companies, South Street Donuts LLC and Commuter Foods Corp., in the amounts of \$5,966.00 and \$472.00, respectively.

5. Petitioner's federal Schedule C, representing his self-employment as a contractor, reported net income of \$10,488.00, consisting of the following items of income and deductions:

ITEM	AMOUNT
Gross Receipts	\$25,300.00
Cost of Goods Sold	(6,600.00)
Insurance	(2,000.00)
Supplies	(100.00)
Other Expenses:	(6,112.00)
Communication	\$1,200.00
Transportation	3,600.00
Tools	1,312.00
Total Expenses	(8,212.00)
Net Profit	\$10,488.00

6. The Division issued to petitioner an audit inquiry notice (inquiry notice) dated May 21, 2012, requesting information to verify his Schedule C business income, wages and dependent care expenses as claimed on his form IT-201 for 2011. Concerning the wages, the Division simply requested the W-2 forms for each employer, and these were submitted as part of the record. Referencing petitioner's self-employment, the inquiry notice stated that petitioner needed to prove his income, and requested the following:

"Send us your Schedule C, *Profit or Loss from Business*, from your federal income tax for the tax year listed above.

In addition, you must send us all of the following:

- **detailed documentation**, such as sales slips, invoices, bank statements, or receipts supporting your business income. Use the actual documents from the time you earned the money or incurred the expenses - estimates are not acceptable. This documentation must cover **at least two months** of the year in question.

- copies of the **summary documents** that you used to calculate the income and expenses that you reported on your tax return. These documents must cover **the entire year**.

- copies of any **license, registration, or certification** that you need for your business (taxicab, cosmetology, health or food service, etc.)

- the enclosed **questionnaire** (be sure to complete all questions).”

Under the section, “**Child and dependent care credit**,” the Division requested the following:

“If you claimed the child and dependent care credit on Form IT-216, send us the following:

Proof of payment

Send us proof of how much of your own money you spent on daycare or childcare for the tax year listed above. We must be able to verify the proof you send us.

Don’t send us proof related to:

- money you received from a public agency, private agency, or family member that you used to pay for this care, or
- money paid by someone else directly to the care provider.”

7. In response to the Division’s inquiry notice, petitioner submitted 11 invoices or work order receipts depicting the home improvement jobs he performed between April and November 2011. The invoices detailed the work to be performed by petitioner for the customer, and almost always stated pricing as including labor and materials.¹ The invoices submitted totaled \$25,786.00 for 2011. Concerning expenses, it is unclear, what, if any, documentation was provided to the Division. Petitioner claims to have mailed the Division all of his original receipts, and the Division denies receipt of any such information.

¹ Only one invoice, for \$300.00, stated it was for materials, without noting that the materials were in addition to labor.

8. The Division responded to petitioner's submission of information by its notice (notice code 4161) dated August 24, 2012, and stated the following:

“This is in reply to the recent inquiry regarding the refund claim for the tax year shown above.

The refund requested cannot be allowed based on the following:

We have reviewed the information you sent in response to our letter dated 5/21/2012.

Our letter specifically asked that you provide verifiable information to document your earned income, any qualifying children claimed and/or dependent care expenses.

The information you provided was either incomplete or unverifiable.

A child living in a household with more than one individual who has earned income is considered a qualifying child for either individual, as long as the child meets the age, residency, and relationship tests for each individual.

In our previous correspondence, we asked you to provide a statement on letterhead of a school or physician indicating the child's name, date of birth, address of record, and the name of parent/legal guardian with whom the child resided during the tax year stated above. The information provided did not show where your dependents lived for the above tax year.

You have not provided copies of canceled checks and/or receipts showing payment for the child care services.

Examples of acceptable documentation include canceled checks, money order receipts along with bank statements. Hand written receipts or letters, by themselves, even if they are notarized, are not verifiable.

Since your response to our inquiry letter did not include the required documentation to verify the relationship, age, and residency of the qualifying child(ren) claimed on your return, the refundable credits claimed have been adjusted or disallowed.”

9. The Division issued an Account Adjustment Notice - Personal Income Tax to petitioner dated January 30, 2013 (account notice). The explanation provided on this notice was

as follows:

“In your protest to the recent informal denial you received, you have provided documentary evidence to verify the residence and relationship with you of your dependents but not the business income, wages or dependent care expenses claimed on your return, as we have requested. Accordingly, the earned income and dependent care credits have been disallowed. However, you have been allowed the empire state child credit recomputed to reflect no valid income and the new york city [sic] school tax credit as indicated in the adjusted refund amount shown.”

The refund allowed by the account notice was \$263.00, i.e., \$200.00 of the \$326.00 Empire State Credit sought by petitioner, and the \$63.00 New York City school tax credit sought by petitioner, leaving \$5,122.00 of petitioner’s claimed refund disallowed (consisting of the New York State and New York City earned income credits in the amounts of \$1,444.00 and \$256.00, respectively, the New York State and City dependent care credit in the amount of \$3,296.00, and a portion of the Empire State child credit in the amount of \$126.00).

10. With regard to his Schedule C self-employment, petitioner submitted the following into evidence: six months of Citibank checking account statements; seven months, three months and two months, respectively, of Chase credit card statements for three separate credit cards; three invoices for purchases made from Superior Relay during 2011 totaling \$329.27; a rental contract for a roto hammer from Home Depot in the amount of \$51.50; and four statements from Utica First Insurance Company showing several billing installments during 2011 and two payments totaling \$865.75.²

11. Petitioner highlighted expenditures on the available statements from his three credit

² A third insurance payment to Utica First was located on a credit card statement on June 29, 2011, in the amount of \$398.50. Thus, the substantiated insurance payments totaled \$1,264.25. Attached to the bills submitted into evidence was a declarations page from petitioner’s liability insurance policy for the policy period 04/12/11 to 04/12/12. Although it showed an annual premium of \$1,587.00, only \$1,264.25 was substantiated.

cards and his checking account, where they represented purchases of materials (cost of goods sold), supplies and tools used in his Schedule C business. Those items, predominantly purchases from Home Depot and a few from Lowe's Home Improvement, totaled approximately \$8,830.00, taking into account any returns made to the same locations (compared to the \$8,012.00 reported for these items; *see* Finding of Fact 5). No source documentation of any kind was provided.

12. Concerning the claimed dependent care credit, petitioner paid the care giver for her services in cash, so he did not have checks to substantiate the payments, and was not given receipts by the day care provider. However, petitioner obtained a sworn statement from the provider, Maude Thomas, that she was the babysitter for petitioner's daughters during 2011, from January to December, each day during the hours needed, and was paid \$135.00 per week for her services. Petitioner reported \$6,400.00 as the amount paid to Ms. Thomas on his Form IT-216, Claim for Child and Dependent Care Credit. Petitioner's former wife also confirmed the day care services that were needed, provided and paid for on behalf of her daughters while petitioner worked.

13. Petitioner did not maintain books and records for the business other than a book in which he recorded the name of the person for whom he was going to perform services. This book was not submitted into the record. He does not itemize materials purchased for his jobs, and relies primarily on his credit card and checking account statements to track his purchases, in addition to some receipts.

14. Petitioner was provided an opportunity post-hearing to submit additional information substantiating his Schedule C income (from bank statement deposits), and expenses (by reference to his credit card purchases and debits to his checking account) representing purchases made for

his business. Petitioner submitted a three-page document with expenses listed for telephone, facsimile services, copying and transportation. There were no invoices for the expenditures. There were no references between the amounts on the submitted document and petitioner's credit card payments or checking account statements. There was no explanation for the manner in which the business use of petitioner's cell phone was determined, though at the hearing it was frequently inferred that many of the expenses were estimated based on a "reasonableness standard." There was no log or record of the miles driven for a van alleged to have been used 100% for business. There was also no explanation of the connection between the trips made and the jobs performed. There was an amount listed for hired labor in the amount of \$540.00 that was not mentioned previously or separately identified as a deduction on petitioner's tax return.

As to income, instead of locating missing bank and credit card statements, and explaining all the deposits on the bank statements, petitioner simply made two columns: business deposits and personal deposits. Under each, he listed dates during 2011 and amounts. The business deposits totaled \$22,794.73 and only four of the ten business deposits could be traced to the checking account statements in evidence. The personal deposits totaled \$23,047.16, and only 6 of the 13 personal deposits could be traced to the checking account statements in evidence. There appear to be transfers in and out of a savings account from the checking account during 2011; however, no information concerning a savings account was presented or discussed. The business deposits were \$2,500.00 less than the income reported by petitioner on his Schedule C, and no explanation was provided for the difference. The personal deposits were in excess of 3.5 times petitioner's income from wages, the only other income source identified. No additional explanation concerning the personal deposits or income for 2011 was provided.

15. A conciliation conference was held by the Bureau of Conciliation and Mediation Services on June 19, 2013, and a Conciliation Order (CMS No. 256513) dated December 20, 2013 was issued to petitioner sustaining the statutory notice.

SUMMARY OF THE PARTIES' POSITIONS

16. Petitioner maintains that he responded to the Division's audit inquiry and notices requesting information concerning his income, business expenses and dependent care expenses, by providing the information, and believes he is entitled to the credits claimed and the refund requested by his 2011 tax return.

17. The Division maintains that petitioner, although requested to do so, did not submit books and records or other sufficient evidence to substantiate the income he earned from his home improvement business, or to substantiate his Schedule C expenses or his child care expenditures, and therefore is not entitled to either the earned income credit or the dependent child care credit for 2011.

CONCLUSIONS OF LAW

A. Tax Law § 606 (d) (1) provides for a New York State earned income credit based on a percentage of the earned income credit allowed under section 32 of the Internal Revenue Code (IRC). Since the state earned income credit is determined based solely on a percentage of the federal credit, it is appropriate to refer to the provisions of the IRC to determine petitioner's eligibility for the earned income credit.

B. The federal earned income credit, provided for pursuant to IRC § 32, is a refundable tax credit for eligible low-income workers. The credit is computed based on a determination of a taxpayer's "earned income," which includes net earnings from self-employment (*see* IRC § 32

[c] [2] [A] [ii]). As pertinent to this matter, “net earnings from self-employment” is defined as gross income from a trade or business less allowable deductions that are attributable to such trade or business (*see* IRC § 1402 [a]). The amount of the credit varies depending on the number of the taxpayer’s qualifying children and the taxpayer’s earned income. As a taxpayer’s income rises above a phase-out threshold, the credit is reduced by the percentage phase-out until it is eliminated at the completed phase-out amount (*see* IRC § 32 [b]). Petitioner bears the burden of proof (*see* Tax Law § 689 [e]) to substantiate the amount of earned income reported on his return.

C. Upon review of the record it is clear that petitioner has failed to meet his burden of substantiating the amounts of earned income reported on his 2011 return (*see* Finding of Facts 10 through 14). With few business records, such as the work order book, which petitioner failed to submit, an incomplete set of bank statements, incomplete credit card statements for three credit cards, savings account statements missing altogether, and a listing of deposits that does not coincide with any other records or his Schedule C, it was simply impossible to verify petitioner’s earned income in order to allow the credits that are computed using earned income. Since petitioner has failed to verify Schedule C income, a critical starting point for the credits in issue, it is not necessary to discuss the gaps in the substantiation of expenditures, of which there are many, to determine net income. Without sufficient documentation to substantiate the claimed earned income for the years at issue, petitioner has failed to meet his burden of proof of entitlement to the disallowed earned income credit for 2011.

D. With respect to the New York State child and dependent care credit, Tax Law § 606 (c) provides that the allowable New York State credit is determined as a percentage of the

federal credit allowable under section 21 of the IRC. As was the case with the earned income credit, it is appropriate to refer to the provisions of the IRC to determine petitioner's eligibility for this credit. IRC § 21 sets forth the requirements for the federal child and dependent care credit. This credit is determined based upon a percentage of employment-related expenses, including expenses for the care of a qualified dependent under the age of 13, incurred by a taxpayer to be gainfully employed, while maintaining a household that includes the qualified dependent. To be eligible for the credit, petitioner bears the burden of proving that he paid child care expenses in 2011, and the burden of substantiating the amount of such expenses he paid (*see Matter of Golub Serv. Sta. v Tax Appeals Trib. of State of N.Y.* 181 AD2d 216 [1992]; *see also* Tax Law § 689 [e]). In this context, petitioner had the burden to establish the amount of his earned income in 2011, which drives the calculation of adjusted gross income, a determining element in the applicable percentage that may be allowable to compute the credit (*see* IRC § 21 [a] [2]), and the amount of the child care expenses he paid in 2011 (*see* IRC § 21 [b] [2]).

E. IRC § 21 (e) (9) requires that the person claiming the credit provide the name, address and taxpayer identification number of the care provider. Petitioner attached to his 2011 resident return a Form IT-216, Claim for Child and Dependent Care Credit, on which he provided the required information for the care provider, Maude Thomas. In addition, Ms. Thomas provided a sworn statement that she was the babysitter for petitioner's daughters during 2011, from January to December, each day during the hours needed, and was paid \$135.00 per week for her services. Petitioner reported \$6,400.00 as the amount paid to Ms. Thomas on his Form IT-216.

Treasury Regulation § 1.21-1 (k) provides that "[a] taxpayer claiming a credit for employment related expenses must maintain adequate records or other sufficient evidence to

substantiate the expenses in accordance” with IRC § 6001 and the regulations thereunder. IRC § 6001, in turn, provides that, “[e]very person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.” Treasury Regulation § 31.6001-1 provides that “records shall be kept accurately, but no particular form is required for keeping the records.” Internal Revenue Services (IRS) Publication 552, Record Keeping for Individuals (2011), states that for proof of payment, “[g]enerally, you prove payment with a cash receipt, financial account statement, credit card statement, canceled check or substitute check. If you make payments in cash, you should get a dated and signed receipt showing the amount and the reason for payment.”

F. On the facts presented here, including specifically the credible testimony of petitioner and his former wife about child care services, it is determined that petitioner has presented sufficient evidence to meet his burden of proving he made payments to Ms. Thomas in the amount of \$6,400.00. However, a different conclusion must be reached, with regard to the child and dependent care credit itself, since petitioner has failed to substantiate his earned income, a key element in the computation of the credit (*see* IRC § 21 [b] [2]). Thus, petitioner has failed to meet his burden of proof of entitlement to the claimed child and dependent care credit for 2011.

G. Tax Law § 689 (e) places the burden of proof on petitioner to show by clear and convincing evidence that the Division’s adjustment of petitioner’s requested tax refund is erroneous (*Matter of Suburban Restoration Co., Inc. v. Tax Appeals Tribunal*, 299 AD2d 751, 750 NYS2d 359 [2002]). Petitioner has not proved by convincing evidence that his earnings and expenses were as reported, such that he was financially qualified for the New York State and City

earned income credits and the New York State child and dependent care credit. Accordingly, petitioner's record-keeping failure and subsequent inability to prove the income he received in 2011 justified the Division's disallowance of such credits. Earned income is the critical element in the calculation of the credits and petitioner's failure to accurately establish that sum is fatal to his claim.

H. The petition of Jones Darkwa is denied, and the Account Adjustment Notice dated January 30, 2013, upheld by the Conciliation Order dated December 20, 2013, is sustained.

DATED: Albany, New York
April 21, 2016

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE