

**BEFORE THE TAX APPEAL BOARD
OF THE STATE OF DELAWARE**

MICHAEL J. PARSONS and RUTH)	
E. PARSONS,)	
)	
Petitioners,)	
)	
v.)	Docket No. 1815
)	
DIRECTOR OF REVENUE,)	
)	
Respondent.)	

DECISION AND ORDER

This case concerns three business expense deductions that Michael J. Parsons (“Mr. Parsons”) and Ruth E. Parsons (“Mrs. Parsons,” and collectively, “Petitioners”) claimed on their joint 2018 Delaware income tax return. The Director of Revenue (“DOR”) contends that Petitioners have either waived the claimed deductions and/or failed to submit evidence sufficient to substantiate them.

For the reasons set forth below, the Board determines that: (i) Petitioners waived any request to include rent payments to Sandals Bridal as a business expense deduction because those rent payments were not listed on Petitioners’ amended Schedule C and because Mrs. Parsons testified she was not claiming the rent expense as a deduction and, in any event, Petitioners have not properly substantiated a rent expense deduction; (ii) Petitioners are allowed a deduction of \$1,658 for their

business phone expenses; and (iii) Petitioners are allowed a deduction of \$292 for their business internet expenses.

Background Facts

The factual record and briefing in this case is at times poorly developed and unclear. Issues that may have impacted the Board's analysis were not addressed by the parties in their factual presentation or briefing. The Board has summarized the record as best it can and ruled on this matter based on the facts and arguments presented.

In March 2018, Petitioners moved to Delaware from Maryland. In 2019, Petitioners filed a Delaware resident joint income tax return for tax year 2018 (the "2018 Return").¹ The 2018 Return included two Schedules C that itemized deductions for two businesses: Reversal Dynamics, an enterprise run by Mr. Parsons that offered trading education and training exercises, and a seamstress business performed by Mrs. Parsons. The DOR asked Petitioners to provide copies of cancelled checks and receipts to substantiate certain of the business expense deductions listed on the 2018 Return.

Over the following months, Petitioners sent DOR documentation that Petitioners believed supported the claimed deductions. DOR reviewed the

¹ Petitioners subsequently amended their 2018 Return by filing a Delaware non-resident return for tax year 2018. Neither party addressed the accuracy or impact of this filing on the issues before the Board. Likewise, neither party addressed whether Petitioners' status as less than full-year residents of Delaware in 2018 impacted the amount of their permissible deductions.

information and determined that some of the claimed expense deductions had not been substantiated. DOR also identified an issue related to how Petitioners had apportioned their income between Delaware and Maryland. DOR sent Petitioners a Proposed Notice of Assessment advising them that they had a net balance due on their 2018 Return. Petitioners protested the Notice of Assessment. In May 2022, DOR sent Petitioners a Notice of Determination that adopted the findings in the Notice of Assessment and denied the protest. Petitioners then filed an appeal with the Board.

The Deductions in Dispute

Petitioners' petition challenged the DOR's findings as to how Petitioners had apportioned income to Maryland and Petitioners' claimed deductions. Since the filing of the petition, the parties have resolved or abandoned many of those issues, such that only three remain. The three remaining issues are:

- (i) can Petitioners deduct \$2,000 for rent that Mrs. Parsons testified she paid Sandals Bridal in connection with her seamstress business?
- (ii) can Petitioners deduct a portion of their phone bills because they used two of their phone lines to conduct their businesses?
- (iii) can Petitioners deduct a portion of their internet bill because Mr. Parsons used the internet in connection with his Reversal Dynamics business?

There is no dispute that Mrs. Parsons ran a seamstress business. Mrs. Parsons testified that, for a portion of 2018, she ran this business from a location outside her

home and she paid \$400 a month in rent. Petitioners' original Schedule C, line item 20b included a deduction of \$2,000 related to these rental payments. Mrs. Parsons claims that she sent copies of the rent checks to DOR substantiating these deductions. DOR claims that it received no checks (or the checks were not for 2018). In any event, no rent checks or other documentary evidence of rental payments was introduced into the record before the Board.

Prior to the March 4, 2024 factual hearing in this matter, Petitioners prepared two amended Schedules C. On the seamstress amended Schedule C, Petitioners removed the \$2,000 in rental payments as claimed deductions on amended line item 20b, and replaced it with \$1,404 in claimed deductions on line item 20b. Hearing Ex. 6. Mrs. Parsons testified that she was not seeking the Sandals Bridal rental payments of \$2,000 as a deduction. March 4, 2024 hearing transcript ("HT") at 21:5–24:5. *See also* HT at 108:23-109:22; 110:16-111:4. DOR is not contesting the \$1,404 deduction.

With respect to deductions for business phone expenses, Petitioners testified that they paid for five phone lines in 2018. Petitioners testified that they used two of the five lines for business and that occasionally they received personal calls on these lines. HT 41:22-42:2; 68:7-24. Petitioners claim the amounts they paid for the two lines are properly deducted business expenses. Petitioners paid \$4,605.25 for their phone service in 2018. Respondent's Appendix in Support of the Answering Brief

(“App.”) at R116. As some of the phone lines and expenses related thereto are personal, not business expenses, Petitioners have prorated the \$4,605.25. They seek a deduction of \$2,400 (\$1,200 each) for the two phone lines they use for their businesses. Hearing Exs. 5 and 12; HT 68:7-10.²

Mr. Parsons testified that he used his home internet service in connection with his Reversal Dynamics business in 2018. The Xfinity/Comcast invoices reflecting the internet expenses were submitted to the Board. App. at R117-132. Those invoices reflect that Petitioners enrolled in a “Standard Double Play” package that includes “Limited Basic, Kids & Family, Entertainment, Sports & News, TV Box W/remote, HD And Performance Pro Internet.” For this bundle of internet and non-internet services, Petitioners pay \$69.99 per month. In addition, Petitioners paid \$11 per month to rent a modem (a necessary component of internet service). There are other charges on the invoices as well and the total invoice per month is \$137.29. Recognizing that some portion of their Xfinity/Comcast bill relates to personal expenses, Petitioners have prorated it and attribute \$50 per month to internet service utilized by Mr. Parsons in his business. App. at R117. Based on this apportionment, Petitioners claim they are entitled to a \$600 business expense deduction for internet expenses on the 2018 Return.

² DOR’s principal witness at the March 4, 2024 factual hearing was an auditor. This witness gave inconsistent testimony regarding whether phone expenses can be prorated when the phone is used for both business and personal communications. Ultimately, she conceded that proration was possible under applicable IRS standards. HT 126:17-128:24.

Analysis

Delaware looks to federal law with respect to “items of loss and deduction that are allowable and includable” on a Delaware state tax return. *Turner v. Director of Revenue*, Dkt. 1417 at 4 (Tax App. Bd. July 12, 2006); 30 *Del. C.* § 1105 (adopting federal adjusted gross income, i.e., federal income after deductions, as the taxable income of a resident of Delaware). Personal, living and family expenses are not deductible, 26 U.S.C. § 262(a), but all “ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business” are allowed as a deduction, 26 U.S.C. § 162(a). A taxpayer bears the burden of proving that he or she is entitled to a business expenses deduction, *see* 30 *Del. C.* § 526 (taxpayer bears burden in proceedings before the Tax Appeal Board), but per federal law if “a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining” the propriety of a claimed deduction, the burden of proof shifts to the taxing authority. 26 U.S.C. § 7491(a)(1).³

³ The taxpayer must also comply with any requirements to substantiate the deduction, maintain all records required by the Internal Revenue Code and cooperate with reasonable requests for information. 26 U.S.C. § 7491(a)(2). Neither party has addressed Section 7491 or whether the burden has shifted back to DOR in this proceeding. Petitioners are credible witnesses and they have introduced credible evidence that the expense deductions at issue are legitimate business expenses and that they cooperated with DOR. The parties did not address if the IRS has established “requirements to substantiate” the claimed expense deductions or if Petitioners did or did not maintain all the records required by the Internal Revenue Code. As a result, it is not possible for the Board to determine whether the burden of proof has shifted back to the DOR.

Given the issue in this case is proper apportionment of expenses between business and personal activities and given the discretion the Board has to estimate recognized in *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930) and its progeny, the Board does not believe the question of who bears

1. The Rent Payments

Petitioners are not entitled to any deduction for the \$2,000 rent payments. Their amended Schedule C for the seamstress business did not include the rent as a claimed deduction and Mrs. Parsons testified she was not seeking a deduction for the rent payments. Hearing Ex. 6; HT at 21:5–24:5. Mrs. Parsons also testified she does not have copies of the rent payment checks. HT 22:12-14. Petitioners have waived their right to claim this deduction and failed to substantiate it.

2. The Telephone Expenses

There is no question Mr. and Mrs. Parsons ran businesses and used phones in conducting those business ventures. Thus, Petitioners are entitled to some deduction, the only issue is the amount of the deduction given that the phone invoices reflect both personal and business expenses.

With respect to that issue, both DOR and Petitioners point to *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930). “Under the *Cohan* rule, if a taxpayer establishes that an expense is deductible but is unable to substantiate the precise amount, the Court may estimate the amount of the deductible expense” *Bass v. Commissioner*, T.C. Memo 2018-19, 2018 WL 1005393, at *2 (Feb. 21, 2018), *aff’d*, 738 F. App’x 178 (4th Cir. 2018). The court “should make as close an approximation as it can, bearing heavily *if it chooses* upon the taxpayer whose inexactitude is of his

the burden of proof has a significant impact on the outcome here. For purposes of our analysis, we have assumed Petitioners bear the burden of proof.

own making. But to allow nothing at all appears to us inconsistent with saying something was spent.” *Cohan*, 39 F.2d at 544 (emphasis added).

The cost of phone service for a phone used in a business endeavor is a deductible business expense. Here, Petitioners had five phone lines for which they paid \$4,605 in 2018. They claim a \$2,400 deduction for their business phones/lines. Per *Cohan*, the Board determines this is too high a deduction. It does not even account for the five phone lines or adjust for any personal use.

The Board concludes that Petitioners’ proper phone expense deduction for 2018 is \$1,658. Per *Cohan*, the Board estimated this figure by dividing the annual phone charges (\$4,605) by the number of lines (5), multiplying by two because each Petitioner had a business line and then reducing the amount by 10% to account for incidental personal use. The record before the Board supports this estimate, and it takes into account two realities: Petitioners have a legitimate business expense for which they can claim a deduction, and no one maintains records of phone line use that would allow for a more precise estimation or calculation (particularly as phone lines are used to transmit business calls and emails and search the internet for business related information). See [ir-11-093.pdf \(irs.gov\)](#) (explaining IRS does not require detailed record keeping regarding the extent of business use of employer provided cell phones since 2011).

3. The Internet Charges

The *Cohan* rule also applies to the internet charges. It is undisputed that Mr. Parsons ran a business that utilized his home internet, and that the expense of business internet is deductible. Petitioners have sought too large of a deduction by including those portions of the Xfinity/Comcast bills that are not related to internet service. Petitioners were charged \$81 per month for services that might be internet related, but even this figure overstates the internet-related amount as Petitioners paid \$70 per month for “bundled” cable and internet services plus \$11 per month for a modem. Considering the record as a whole, the Board determines that Petitioners are allowed a deduction of \$292 for their business internet expenses. This figure is calculated as 30% of the \$81 monthly charge, multiplied by 12 months. The Board reduced the \$81 monthly charge by 70% to account for the non-internet services (cable and other package items) and to account for personal use of the internet services. Based on the record, the Board believes this is a reasonable estimate of the deduction per *Cohan*.⁴

⁴ The Board notes that, absent other facts and circumstances, it does not seem economical for parties to litigate over deductions of this size. Given the costs associated with this proceeding (amounts spent on hearing transcripts, photocopying, travel for the auditor and Petitioners, etc.), the time spent addressing it that could have been used elsewhere and the marginal impact of deductions of this size on overall tax liability, it seems likely that any benefit achieved is outweighed by the burden that the taxpayers and DOR bore. In the future, the Board hopes that parties can take a more pragmatic approach and resolve disputes involving such small amounts without the need to litigate.

The Board believes that the parties can implement this Decision and Order, as well as the other changes that have arisen as a result of the parties' prior settlement efforts and Petitioners' amended Schedules C, without further input from the Board. More specifically, Petitioners' Schedules C should be adjusted consistent with this Decision and Order and the other changes agreed to by the parties, including those changes on the amended Schedules C, and Petitioners' 2018 tax liability should be recalculated based on the revised Schedules C. If the parties cannot agree on how to implement this ruling or any other issues related to Schedules C deductions that were the subject of prior settlement efforts, then they should file a joint letter with the Board within 30 days that identifies the issue(s) in dispute and sets forth both parties' positions on the issue(s).

If no such motion is filed, this Decision and Order shall become final on November ^{29th}, 2024. Any party will have 30 days from that date to file an appeal with the Superior Court. 30 Del. C. § 331.

SO ORDERED this ^{28th} day of ^{October}, 2024.

Paul C. Kelly

Jan M. Winters

M. Lynn Fuller

Robert M. Shain / YES