John O. Johnson
Tax Counsel
Board of Equalization, Appeals Division
450 N Street, MIC:85
PO Box 942879
Sacramento CA 95814
Tel: (916) 323-3140
Fax: (916) 324-2618

Attorney for the Appeals Division

BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEAL
PATRICK T. MEAD AND	Case No. 520063
MELISSA A. MEAD[1]	

Years	Claims For Refund
2006	$5,973.25
2007	$7,815.50[2]

Representing the Parties:

For Appellants: Amber Bridges, TAAP[3]

For Franchise Tax Board: Nancy E. Parker, Tax Counsel III

QUESTION: Whether the demand penalties should be abated based on a showing of reasonable cause for appellants' failure to respond to respondent's Demand for Tax Return.

[1] Appellants reside in Calabasas, Los Angeles County, CA.

[2] On appeal, respondent concedes the claim for refund for the 2007 tax year. (Resp. Reply Br., p. 1.)

[3] Appellants filed their own appeal letter. Subsequent representation has been provided by the Tax Appeals Assistance Program (TAAP), including the filing of appellants' reply brief and additional brief.

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Background

2006

Appellants did not file a timely California income tax return for 2006. Respondent issued a Demand for Tax Return (Demand) on March 3, 2008, to appellants' address on Falcon Bluff Street in San Diego, California. The Demand, addressed to appellant-husband only, required him to respond by April 2, 2008, by filing a return, providing a copy of his return if he already filed one, or explaining why he did not need to file a return. (Resp. Op. Br., exhibit A.) Respondent indicates it did not receive a reply from appellant-husband and issued a Notice of Proposed Assessment (NPA) to him at the Falcon Bluff Street address on May 19, 2008. (*Id*. at exhibit B.) There is no evidence in the record that either the Demand or the NPA was returned undeliverable by the United States Postal Service (USPS). (*Id*. at p. 1, fn. 1.)

Respondent's NPA was based on reported income for appellant-husband of $415,173.[4] (Resp. Op. Br., exhibit B, p. 2.) The NPA applied the standard deduction of $3,410, proposed a tax liability of $36,165, and after applying $28,751 in reported withholding calculated an unpaid tax liability of $7,414. Respondent also proposed a late filing penalty of $1,853.50, a failure to file upon demand penalty (demand penalty) of $9,041.25, interest of $843.80, and a filing enforcement fee of $122.00. (*Id*. at exhibit B, p. 1.) Appellant-husband did not timely protest the NPA, and, in accordance with the terms listed on the NPA, it became final after sixty days. Subsequently, respondent commenced involuntary collections by issuing Earning Withholding Orders for Taxes (EWOTs) in February of 2009, and imposed a collection cost recovery fee of $187. The EWOTs, sent to appellant-husband's known employers and payors, resulted in the collection of $6,144.64 in April and May of 2009. (*Id*. at p. 2.)

On June 5, 2009, appellant-husband contacted respondent to cease the involuntary collection actions, and respondent then released the EWOTs and put a hold on the collection action. (Resp. Op. Br., p. 2 & exhibit C.) On June 9, 2009, respondent received appellants' 2006 income tax

[4] Appellant-husband's income was reported to respondent in the following amounts and sources: wages of $340,193 from his employer, AXA Distribution Holding Corp.; dividend income of $4,773 and $2,513 from Pershing LLC and AXA, respectively; and miscellaneous income on 1099s in the amounts of $56,137, $11,436, and $121 from AXA Equitable, AXA Distribution Holding Corp., and Pershing LLC, respectively. (Resp. Op. Br., p. 2 & exhibit B, p. 2.)

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return. Respondent indicates the return reported California adjusted gross income of $384,210, deductions of $81,520, and taxable income of $302,690. The return applied withholding credit of $28,809[5] against a tax liability of $23,893, resulting in a claimed refund of $4,916. Respondent added the $6,144.64 received through the collection action to the claimed refund for a total credit of $11,060.64. (*Id*. at p. 2.) As a result of the new tax shown on the return and all payments, respondent reduced the demand penalty from $9,041.25 to $5,973.25. Respondent applied the credit balance to the amount due, comprised of the penalty, interest, and fee, resulting in a credit balance of $4,836.57. (*Ibid*.)

Appellants claimed a refund of $5,973.25, the adjusted amount of the demand penalty. Respondent denied the refund request in a letter dated October, 23, 2009, stating appellants had not shown reasonable cause for abatement of the penalty.[6] This timely appeal followed.

2007

Appellants claim a refund of $7,815.50, the amount of the demand penalty for 2007. On appeal, respondent concedes the claim for refund for the 2007 appeal year.[7] (Resp. Reply Br., p. 1.)

Appellants' Residences and Mailing Addresses

The physical location of where appellants lived during certain periods does not appear to be disputed. Rather, the parties' disputes concern whether appellants should have received or be treated as having received the Demands.

Appellants provide on appeal a list of their residential addresses and the dates they were living at these residences. The following list provides the periods appellants state they lived at each address (there are no reported date gaps between residences):

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[5] Respondent notes appellants listed withholding credit of $28,751, to which respondent added withholding credit of another $58 that it located. (Resp. Op. Br., p. 2, fn. 2.)

[6] The denials of the claims for refund issued for 2006 and 2007 both state that appellants' claim for refund of the late filing penalty amount is denied. However, since appellants' withholding satisfied their tax obligation for each year, there were no late filing penalties assessed for the years at issue, and the amounts requested in appellants' claims for refund reflect the amount of the demand penalties. Therefore, the penalty amounts at issue are for demand penalties and not late filing penalties. (See App. Reply Br., p. 5; Resp. Op. Br., p. 1.)

[7] Staff notes respondent issued the Demand for 2007 to an address on Collier Drive in Denison, TX. (Resp. Op. Br., exhibit D.) Although respondent does not provide a reason for conceding the 2007 demand penalty, it appears the demand may have been sent to an individual not involved with this appeal who happens to share the same name as appellant-husband.

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Early August 2002 - Early September 2004	Caminito Faro in La Jolla, California (Owner)
Early September 2004 - August 27, 2007	Avocado Place in Del Mar, California (Owner)
August 28, 2007 - March 21, 2008	Falcon Bluff Street in San Diego, California (Rental)
March 22, 2008 - Present	Circa Del Sur in Rancho Santa Fe, California (Owner)

(App. Reply Br., attachment: Statement of Patrick T. Mead.) The statement lists the Circa Del Sur address as still being owned by appellants at the time of its writing, and an address on Calle Jazmin in Calabasas, California, as being appellants' rental home and current mailing address. (*Ibid*.)

The address listed on appellants' 2005 tax return, received by respondent on January 2, 2007, was the Avocado Place address. (Resp. Reply Br., p. 2.) Appellant-husband asserts he never provided the Falcon Bluff Street address to respondent, and states that while he did live in Texas for most of his life, he has never lived in or near Dennison, Texas. (App. Reply Br., attachment.) Respondent states that when it was preparing notices regarding the 2006 year, it reviewed the most recent income information received from appellant-husband's employer, AXA Distribution Holding Corp., which reported his address as the Falcon Bluff address when reporting income through the end of 2007. (Resp. Reply Br., p. 2 & exhibit H.)

Contentions

The 2007 claim for refund has been conceded by respondent, leaving the 2006 demand penalty as the only remaining issue. The following contentions refer only to the 2006 claim for refund.

Appellants' Contentions

Appellants contend the filing of their 2006 return was delayed because necessary records relating to property basis were unknowingly left in a remote storage location during 2002. Appellants state they contacted a Franchise Tax Board (FTB) employee regarding this dilemma prior to the due date of their tax return and were informed that a late filing penalty would not apply if their withholding and other credits satisfied their tax liability. (Appeal Letter.) Appellants assert this advice supports an equitable estoppel claim preventing respondent from enforcing the demand penalty. Appellants state the FTB agent's information caused appellants to file late, that they did not know about the demand penalty possibility, and that the agent should have informed them that a demand penalty may apply if they chose to file late. (App. Reply Br., pp. 5-6.)

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Appellants assert they never received the Demand sent to the Falcon Bluff Street address, and that it does not constitute the last-known address. Appellants state they never reported the Falcon Bluff Street address to respondent because it was a temporary address, and respondent should not have relied upon address information retrieved from appellant-husband's employer. (App. Add'l Br., pp. 1-2.) Appellants assert respondent should have relied upon the address on their late-filed 2005 return as their last-known address, and even though they no longer resided at that location, the USPS would have forwarded their mail to appellant-husband's business address at 701 B Street in San Diego.[8] (App. Reply Br., p. 6.)

Appellants contend they acted at all times in a manner consistent with an intelligent and prudent businessperson, and therefore the demand penalty should be abated for reasonable cause. (App. Reply Br., p. 8.) In support of this contention, appellants indicate they contacted respondent prior to the filing deadline and verified there would be no late filing penalty if their tax liability was satisfied, and immediately upon becoming aware of the demand penalty, via respondent's collection actions, they promptly contacted respondent and filed their return. (*Id*. at p. 2.)

Respondent's Contentions

Respondent contends the demand penalty for 2006 is properly imposed, since appellants did not respond to the Demand as required. Respondent indicates it issued a Request for Tax Return for appellant-husband's 2004 tax returns, to which it received no response from appellants and issued an NPA. (Resp. Op. Br., p. 4.) Respondent asserts appellants have not met their burden of proving reasonable cause. Respondent contends misplaced records that are still in the control of appellants, although possibly difficult to obtain, do not constitute reasonable cause. (*Id*. at pp. 4-5.)

Respondent asserts equitable estoppel is not applicable here. Respondent reasons, among other things, appellants have not proven detrimental reliance on respondent's alleged advice. (Resp.

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[8] The parties provide contentions regarding whether the Demand would have been properly forwarded to appellant-husband's work address by the USPS had respondent issued the Demand to the Avocado Place address, at which appellants no longer resided when the Demand was issued. The discussion focuses on whether the USPS forwards mail for six months following a move or longer, since the Demand was issued approximately seven months after appellants left the Avocado Place address. (See Resp. Reply Br., p. 3; App. Add'l Br., p. 2.) Despite the opposing contentions, it appears neither party provided evidence from the USPS to support their argument regarding this hypothetical scenario. Should the parties wish to argue this issue at the hearing, supporting evidence should be provided.

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Reply Br., p. 1.) Respondent asserts the information that appellants allegedly relied on was informal advice from one of its employees, given before the Demand was issued, regarding only the late filing penalty and not the demand penalty, and ultimately proved to be factually correct advice. (Resp. Op. Br., p. 5.) Respondent contends the demand penalty resulted from appellants' failure to respond to the Demand, and not from the alleged advice, and, for that reason, appellants may not assert equitable estoppel against respondent. (Resp. Reply Br., p. 2.)

Respondent contends it issued the Demand to appellants' last-known address. Respondent states it received appellants' 2005 tax return on January 2, 2007, which listed the Avocado Place address, but subsequently received information from appellant-husband's employer reporting wages and dividends through the end of 2007 indicating appellant-husband's address was on Falcon Bluff Street. (Resp. Reply Br., p. 2.) While the Avocado Place address was the address listed on the last received return, respondent determined that the Falcon Bluff Street address was more current based on the employer's information return. In accordance with R&TC section 18416, subdivision (c), respondent states that it considered the Falcon Bluff Street address to be appellants' last known address because it had reason to believe that it was their most current address. In addition to being the last-known address, respondent also notes appellants were physically residing at the Falcon Bluff Street address when respondent issued the Demand, and for over three weeks thereafter. (*Id*. at p. 3.)

Applicable Law

Demand Penalty

California imposes a demand penalty when taxpayers fail to provide requested information or file a return upon notice and demand by respondent, unless it is shown that such failure was due to reasonable cause and not willful neglect. (Rev. & Tax. Code, § 19133.) The burden is on the taxpayers to prove that reasonable cause prevented them from responding to the demand. (*Appeal of Kerry and Cheryl James*, 83-SBE-009, Jan. 3, 1983.) The penalty is proper where the taxpayers have not responded within the time period set forth by the Demand. (*Appeal of Irma E. Bazan*, 82-SBE-259, Nov. 17, 1982.)

California Code of Regulations, title 18, section 19133 (Regulation 19133) provides two conditions for the imposition of the demand penalty. Regulation 19133 states that the demand penalty

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should only be imposed if: (1) the taxpayers fail to timely respond to a Demand, and (2) the FTB has proposed an assessment of tax under R&TC section 19087, subdivision (a), after the taxpayers have failed to timely respond to a Demand or Request for Tax Return at any time during the four-taxable-year period preceding the taxable year for which the current demand letter is issued. The amount of the penalty is 25 percent of the amount of tax determined pursuant to R&TC section 19087 or of any tax deficiency assessed by the FTB. (Rev. & Tax. Code, § 19133.) The penalty imposed by this section is properly computed on the amount of the total correct tax liability as of the return due date before deduction of credits (including withholding credits). (*Appeal of Robert Scott*, 83-SBE-094, Apr. 5, 1983.)

Burden of Proof

Demand penalties may be abated if the taxpayers' failure to provide information or to file a return is due to reasonable cause and not willful neglect. (Rev. & Tax. Code, § 19133.) Without evidence to the contrary, it is presumed that respondent's determinations of penalties are correct. (*Appeal of Robert Scott*, *supra*.) Appellants bear the burden of showing that imposition of a penalty was improper. (*Appeal of Kerry and Cheryl James*, *supra*.)

Last-known Address

The Board has long recognized a presumption in favor of respondent arising from the "last-known address rule." Under this rule, the Board presumes respondent's mailing of a statutory notice to taxpayers provides notice to the taxpayers of the tax due, so long as respondent mailed the notice to the taxpayers' last-known address, even if the taxpayers did not actually receive the notice. (*Appeal of Yvonne M. Goodwin*, 97-SBE-003, Mar. 19, 1997; *Appeal of Jon W. and Antoinette O. Johnston*, 83-SBE-238, Oct. 26, 1983.) The taxpayers' last-known address is the address shown on the taxpayers' most recently filed return, unless respondent is given clear and concise notice of a different address. (*King v. Commissioner* (9th Cir. 1988) 857 F.2d 676, 679; *Wallin v. Commissioner* (9th Cir. 1984) 744 F.2d 674, 676.) If respondent has reason to believe that an address is the most current address for the taxpayers, then that address shall be the last-known address. (Rev. & Tax. Code, § 18416, subd. (c).) Respondent must exercise reasonable care and due diligence in determining the correct address for mailing of a notice, and the relevant inquiry is to respondent's knowledge of appellants' last-known

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address, rather than what may in fact be appellants' most current address. (*Reding v. Commissioner* (1990) 59 T.C. 793.) The purpose of this rule is to protect the taxing agency and the statutory scheme of assessment and appeal from a failure by the taxpayers to inform the taxing agency of a change in address. (*Delman v. Commissioner* (3rd Cir. 1967) 384 F.2d 929, 933.) The presumption in the last-known address rule in favor of respondent is not absolute. Appellants may overcome the presumption by proving by a preponderance of the evidence that respondent failed to send the required notices to appellants' last-known address. (See Cal. Code Regs., tit. 18, § 5080.)

Equitable Estoppel

The doctrine of equitable estoppel as applied to a taxing agency such as FTB provides that FTB is barred or "estopped" from asserting a tax liability against taxpayers if FTB has taken an action that the taxpayers relied upon to their detriment. The detriment to the taxpayers must be an increased tax liability.[9] (*Appeal of Robert C. and Betty L. Lopert*, 82–SBE-011, January 5, 1982.) Estoppel will be applied against FTB only when all of the elements of estoppel are present and when application is necessary to prevent great injustice. (*United States Fidelity and Guaranty Co. v. State Board of Equalization* (1956) 47 Cal.2d 384, 390.) The elements of estoppel are present only if the following four conditions are satisfied:

1) FTB must be advised of the true facts;
2) FTB must intend that the taxpayer act upon FTB's conduct or the nature of FTB's conduct must indicate that the taxpayer had a right to believe that FTB intended the taxpayer to so act;
3) The taxpayer must be ignorant of the true facts; and
4) The taxpayer must show detrimental reliance.

(*Appeal of Priscilla L. Campbell*, 79-SBE-035, Feb. 8, 1979.)

Estoppel is an affirmative defense and the taxpayers bear the burden of establishing the facts necessary to support the claim. (*Appeal of Virgil E. and Izora Gamble*, 76-SBE-053, May 4,

[9] Although the language used here states "increased tax liability," it appears to also incorporate penalties. The Board has noted in other decisions regarding equitable estoppel that interest "…constitutes compensation for the use of money, rather than a penalty," suggesting interest charges are distinguishable and immune from equitable estoppel claims, while concurrently suggesting that penalties are not. (*Appeal of Priscilla L. Campbell*, 79-SBE-035, Feb. 8, 1979.)

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1976.) The Board has held that reliance on informal opinions of respondent's employees does not create estoppel against respondent. (*Appeal of Virgil E. and Izora Gamble*, *supra*; *Appeal of Mary M. Goforth*, 80-SBE-158, Dec. 9, 1980.)

Reasonable Cause

To establish reasonable cause for a demand penalty, the taxpayers must show that the failure to properly respond "occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances." (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979; see also *Appeal of Elmer R. and Barbara Malakoff*, 83-SBE-140, June 21, 1983.) Illness and other personal difficulties that prevent taxpayers from timely responding to a demand notice may constitute reasonable cause under some circumstances. However, taxpayers must be prevented from timely providing information, and not merely sacrificing the timeliness of one aspect of the taxpayers' affairs to pursue other aspects. (*Appeal of Michael J. and Diane M. Halaburka*, 85-SBE-025, April 9, 1985; *Appeal of William T. and Joy P. Orr*, 68-SBE-10, Feb. 5, 1968.) The Board has held that a taxpayer's belief that no penalties will apply because no tax was due does not constitute reasonable cause for the failure to respond timely to a notice and demand letter. (*Appeal of Frank E. and Lilia Z. Hublou*, 77-SBE-102, July 26, 1977.)

STAFF COMMENTS

Demand Penalty

Respondent issued the 2006 Demand on March 3, 2008, giving appellants until April 2, 2008, to respond. Appellants did not respond by the stated due date, and respondent assessed the demand penalty. Respondent indicates it issued a Request for Tax Return to appellant-husband for 2004, within 4 years of the tax year at issue, and subsequently issued an NPA after appellant-husband failed to respond to the request. Based on these facts, it appears the demand penalty was imposed according to the relevant statute and regulation.

Respondent initially based the penalty on the estimated tax amount contained in its NPA. After appellants filed their tax return, respondent reduced the penalty from $9,041.25 to $5,973.25 to reflect the self-assessed tax amount. While R&TC section 19133 states that the penalty may be based

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upon any relevant deficiency tax assessed by the FTB, the Board has previously held that the penalty should be based upon the amount of tax due as of the filing date of the return (i.e., the estimated tax amount from the NPA), and not the amount of tax shown upon the late return. (See *Appeal of Robert Scott, supra*; *Appeal of Irma E. Bazan, supra*; *Appeal of Frank E. and Lilia Z. Hublou, supra*.) Nevertheless, respondent voluntarily reduced the demand penalty by $3,068 so the calculation of the penalty is based on the accepted self-assessed tax shown on appellants' late-filed return. Appellants do not appear to argue the amount of the penalty is incorrect, only that it should be abated based on a number of theories (discussed below).

Last-known Address

If respondent mails a Demand to a taxpayer's last-known address, then the Demand is treated as received and failure to properly respond may result in a demand penalty. (*Appeal of Yvonne M. Goodwin*, 97-SBE-003, Mar. 19, 1997; *Appeal of Jon W. and Antoinette O. Johnston*, 83-SBE-238, Oct. 26, 1983.) Appellants assert they never received the Demand or NPA respondent sent regarding their 2006 filing requirement until after they were made aware of the collection actions taken by respondent during 2009. The Demand and NPA were sent to the Falcon Bluff Street address, but appellants assert they should have been sent to the Avocado Place address listed on their 2005 tax return. Although appellants were currently living at the Falcon Bluff Street address at the time of mailing of the Demand and for approximately three weeks thereafter, appellants state the USPS would have forwarded correspondence sent to the Avocado Place address, where they no longer lived, to appellant-husband's business mailing address. Appellants should be prepared to explain why they would not have received the Demand, even though it should have been delivered prior to their moving from the Falcon Bluff Street address.

Appellants state they did not notify respondent of a change in address when they left Avocado Place and moved to Falcon Bluff Street because their stay at Falcon Bluff Street was going to be temporary (seven months). The parties should be prepared to discuss whether it was reasonable for appellants to not inform respondent of their change in address and to rely on the USPS to forward mail from their previous address to appellant-husband's work address for no less than seven months. Appellants should be prepared to discuss why the Falcon Bluff Street address information received by

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respondent from appellant-husband's employer should not be considered the last-known address, even though appellants' 2005 return listing the Avocado Place address was filed approximately one year earlier.

Reasonable Cause

Should the Board find appellants received the Demand or should be treated as having received the Demand (i.e., the Demand was sent to appellants' last-known address), then only reasonable cause can excuse the penalty. Appellants argue that they acted like intelligent prudent business persons by "not check[ing] the mail at a prior temporary address that was never provided to respondent, nor had any mail forwarded to such address." The record shows the appellants lived at the address to which the Demand was mailed so at the hearing appellants should be prepared to explain the basis for their statement that it was a "prior" address. Also, appellants should be prepared to discuss whether in the exercise of ordinary care, intelligent and prudent business persons would have notified respondent of their new address (either the Falcon Bluff Street address or appellant-husband's business address where their mail was forwarded); and whether they actually received the Demand sent to the address where they currently lived.

Equitable Estoppel

Appellants put forth an equitable estoppel argument as reasonable cause for the non-response to the Demand. The parties should be prepared to discuss whether the alleged advice given by respondent's agent constitutes an action upon which equitable estoppel can be based. In doing so, appellants should provide any evidence of such advice, and explain why the holdings in the *Appeal of Virgil E. and Izora Gamble, supra*, and the *Appeal of Mary M. Goforth, supra*, which state reliance on informal opinions of respondent's employees does not create estoppel against respondent, should not apply. In addition, the parties should discuss whether this alleged advice, which addressed only the late filing penalty, may be the basis of an equitable estoppel argument to abate the demand penalty, a completely separate penalty. The parties should also address whether correct advice (i.e., appellants would not be subject to a late filing penalty if their tax liability was fully paid by the filing deadline) can support a claim of equitable estoppel.

The first element that appellants need to prove to claim equitable estoppel is that the FTB

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was aware of all the facts when it gave the advice. It appears that here, where the alleged advice was given prior to the Demand being sent, respondent was not aware of all the facts that led to the penalty since those facts had not yet transpired. Appellants should be prepared to discuss how respondent could have been fully apprised of the facts, if the subsequent issuance of the Demand led to the demand penalty. The final element requires detrimental reliance on respondent's conduct. The demand penalty is based upon appellants' failure to respond to the Demand. Appellants must show they detrimentally relied on the statements of respondent, and that reliance, as opposed to appellants' failure to act, resulted in imposition of the demand penalty. (*Appeal of Priscilla L. Campbell*, 79-SBE-035, Feb. 8, 1979[10]; *Appeal of Baldar Industries, Inc., et al.*, 87-SBE-011, Mar. 3, 1987.)

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[10] In the *Appeal of Priscilla L. Campbell, supra*, the Board found there was not detrimental reliance when appellant's actions that led to the increase in tax liability predated the alleged advice that appellant claimed to rely on. In this appeal, the alleged advice appellants claim to rely on to their detriment was given well before the Demand was even issued (appellants state on page 4 of their reply brief they were given the alleged advice January 16, 2007, and the Demand was issued March 3, 2008).

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