

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, v. TRACY CHANG, Defendant-Appellant.	No. 17-10250 D.C. No. 3:15-cr-00067-WHO-1 MEMORANDUM* (Filed Jul. 12, 2018)
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UNITED STATES OF AMERICA, v. HOWARD HSU, Defendant-Appellant.	No. 17-10256 D.C. No. 3:15-cr-00067-WHO-2
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Appeals from the United States District Court
for the Northern District of California
William Horsley Orrick, District Judge, Presiding

Submitted July 9, 2018**
San Francisco, California

* This disposition is not appropriate for publication and is
not precedent except as provided by Ninth Circuit Rule 36-3.

** The panel unanimously concludes this case is suitable for
decision without oral argument. Fed. R. App. P. 34(a)(2).

App. 2

Before: GRABER and TALLMAN, Circuit Judges, and LEMELLE,*** District Judge.

Defendants Tracy Chang and Howard Hsu were convicted of several tax-fraud related offenses. They appeal their convictions and sentences on several grounds. We have jurisdiction under 18 U.S.C. § 3742 and 28 U.S.C. § 1291, and we affirm.

1. The district court did not err in its rulings on Defendants' motion to suppress. *See United States v. Ruckes*, 586 F.3d 713, 716 (9th Cir. 2009) (stating standard of review for motions to suppress). First, the court correctly concluded that Hsu lacks Fourth Amendment standing to challenge the search of Chang's house. *See United States v. \$40,955.00 in U.S. Currency*, 554 F.3d 752, 757–58 (9th Cir. 2009) (holding that an adult who did not live with her parents lacked Fourth Amendment standing to challenge a search of their house despite the fact that she "had free access and a key to the house . . . [and] stored items in [a] safe" that was opened during the search). Second, because the search warrant limited the items that could be seized to those related to a specific time period, it was not a "general" warrant requiring total suppression. *See United States v. Kow*, 58 F.3d 423, 427 (9th Cir. 1995) (holding that a warrant was defective because, among other shortcomings, it "did not limit the scope of the seizure to a time frame within which the

*** The Honorable Ivan L.R. Lemelle, United States District Judge for the Eastern District of Louisiana, sitting by designation.

App. 3

suspected criminal activity took place”). The district court correctly concluded that the overbroad portions of the warrant were severable and required only partial suppression. *See United States v. SDI Future Health, Inc.*, 568 F.3d 684, 707 (9th Cir. 2009) (holding that partial suppression was appropriate where “the lion’s share of the [warrant] did not violate the Fourth Amendment”); *United States v. Kow*, 58 F.3d 423, 427 (9th Cir. 1995) (holding that a warrant was defective because, among other shortcomings, it “did not limit the scope of the seizure to a time frame within which the suspected criminal activity took place”). Finally, we agree with the district court that the affidavit submitted to obtain the warrant provided the judge with a substantial basis to conclude that there was probable cause to search Chang’s house, including any computers found there. *United States v. Gourde*, 440 F.3d 1065, 1069 (9th Cir. 2006) (en banc).

2. We reject Defendants’ challenges to the jury instructions. The instruction on filing a false tax return included every element of the crime, and the district court did not abuse its discretion by including the “filing” element along with the “knowledge of falsity” element in a single paragraph. *See United States v. Thurnhuber*, 572 F.2d 1307, 1309 (9th Cir. 1977) (“While . . . it would perhaps have been better for the trial court to have given a separate instruction particularizing the element of materiality, we cannot say that the instructions were misleading when viewed as a whole.”). The “aiding and advising” instruction, read as a whole, “fairly and adequately covered the

App. 4

elements” of the offense, *United States v. Jinian*, 725 F.3d 954, 965 (9th Cir. 2013), and the district court did not abuse its discretion by denying Hsu’s request to alter the instruction, *United States v. Keyser*, 704 F.3d 631, 641–42 (9th Cir. 2012). Finally, Defendants were not entitled to either a “good faith” or a “reliance” instruction, because the court instructed the jury that it could convict Defendants only if it found that they “*knew* federal tax law imposed a duty on [them], and the[y] intentionally and voluntarily violated that duty.” *See United States v. Sarno*, 73 F.3d 1470, 1487–88 (9th Cir. 1995) (holding that a defendant is not entitled to either a good-faith or a reliance instruction where an adequate instruction on specific intent is given).

3. Reviewing de novo, *United States v. Pang*, 362 F.3d 1187, 1193 (9th Cir. 2004), we conclude that there was neither a constructive amendment to, nor a fatal variance from, the indictment. The Government’s theory of the case, both in the indictment and at trial, was that Defendants overstated or invented deductions in order to avoid paying taxes. Although the Government introduced evidence that Defendants hid assets from their accountants, neither the Government nor the jury instructions invited the jury to convict Defendants for that conduct. *See United States v. Carlson*, 616 F.2d 446, 447–48 (9th Cir. 1980) (finding a constructive amendment of the indictment where “[t]he instructions as given . . . permitted the petit jury to find appellant guilty . . . based upon misconduct other than that upon which the grand jury based its charge” and

App. 5

the Government “invited . . . [the jury] to find appellant guilty by reason of such misconduct [during its] . . . closing statement”).

4. Even assuming that Chang has preserved her challenge to the admission of certain statements that she made to agents during the execution of the search warrant at her house, we conclude that her challenge is unpersuasive. Either Chang was not in custody or, if she was in custody, she waived her *Miranda* rights. Either way, her statements are admissible under the Fifth Amendment. *See Hernandez v. Holland*, 750 F.3d 843, 853 (9th Cir. 2014) (noting that volunteered statements made by a defendant are admissible); *United States v. Vallejo*, 237 F.3d 1008, 1014 (9th Cir. 2001) (noting that “a confession obtained during a custodial interrogation [is] admissible[]” if the defendant waived her *Miranda* rights). And Chang’s detention was permissible under the Fourth Amendment as a detention incident to the execution of a search warrant, so her statements are not the fruits of an unlawful seizure. *Bailey v. United States*, 568 U.S. 186, 193 (2013).

5. Reviewing de novo, we reject Defendants’ *Brady* claim. *See United States v. Price*, 566 F.3d 900, 907 (9th Cir. 2009) (stating standard of review). Even assuming that the Government should have turned over redacted copies of the thousands of tax returns prepared by Defendants’ accountants for other clients during the relevant years, we are confident that there is no reasonable probability that the evidence would have changed the outcome of the trial. *See id.* at 911

App. 6

(discussing the harmlessness standard for *Brady* claims).

6. Defendants' argument that they are entitled to a new trial because of allegedly improper statements made by the prosecutor fails. The statements referenced by Defendants were not improper.

7. The district court did not clearly err in calculating the amount of tax loss. *See United States v. Stargell*, 738 F.3d 1018, 1024 (9th Cir. 2013) (stating the standard of review). The calculation of tax loss is always "hypothetical" in the sense that, because the taxes were not actually paid, it must be determined what *should* have been paid. The California tax loss in this case was "hypothetical" only in that sense, and the district court did not err in including it in its tax-loss calculation. *See United States v. Yip*, 592 F.3d 1035, 1038–39 (9th Cir. 2010) (holding that tax loss may include unpaid state taxes).

AFFIRMED.

**UNITED STATES DISTRICT COURT
Northern District of California**

**UNITED STATES) JUDGMENT IN A
OF AMERICA) CRIMINAL CASE**
v.) (Filed Jun. 2, 2017)
Howard Hsu) USDC Case Number:
) CR-15-00067-002 WHO
) BOP Case Number:
) DCAN315CR00067-002
) USM Number: 20384-111
) Defendant's Attorney:
) Robert Edward Barnes
) (Retained),
) Tony Nasser (Retained)

THE DEFENDANT:

pleaded guilty to count(s): _____

pleaded nolo contendere to count(s): _____ which was accepted by the court.

was found guilty on counts: One, Four Five, & Six of the Indictment after a plea of not guilty

The defendant is adjudicated guilty of these offenses:

Title & Section	Nature of Offense	Offense Ended	Count
18 U.S.C. § 371	Conspiracy to Defraud the United States	March 1, 2011	1

App. 8

26 U.S.C. § 7206(2)	Aiding and Assisting in the Preparation and Presentation of a False Tax Return	December 28, 2010	4
26 U.S.C. § 7206(2)	Aiding and Assisting in the Preparation and Presentation of a False Tax Return	September 14, 2010	5
26 U.S.C. § 7206(2)	Aiding and Assisting in the Preparation and Presentation of a False Tax Return	March 1, 2011	6

The defendant is sentenced as provided in pages 2 through 7 of this judgment. The sentence is imposed pursuant to the Sentencing Reform Act of 1984.

- The defendant has been found not guilty on count(s):
- Count(s) dismissed on the motion of the United States.

It is ordered that the defendant must notify the United States attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid. If ordered to pay restitution, the defendant must notify the

App. 9

court and United States attorney of material changes in economic circumstances.

5/26/2017

Date of Imposition of Judgment

William H. Orrick

Signature of Judge

The Honorable William H. Orrick III

United States District Judge

Name & Title of Judge

6/2/2017

Date

IMPRISONMENT

The defendant is hereby committed to the custody of the United States Bureau of Prisons to be imprisoned for a total term of:

33 months – This term consists of 33 months on Counts 1, 4, 5, & 6, all counts to be served concurrently

The appearance bond is hereby exonerated, or upon surrender of the defendant as noted below. Any cash bail plus interest shall be returned to the owner(s) listed on the Affidavit of Owner of Cash Security form on file in the Clerk's Office.

- The court makes the following recommendations to the Bureau of Prisons:
The defendant be designated to FCI Mendota
- The defendant is remanded to the custody of the United States Marshal.

App. 10

- The defendant shall surrender to the United States Marshal for this district:
 - at _____ on (no later than 2:00 pm). _____.
 - as notified by the United States Marshal.
- The defendant shall surrender for service of sentence at the institution designated by the Bureau of Prisons:
 - at 9:00 am on 8/1/2017 (no later than 2:00 pm). If no facility has been assigned by the date of self-surrender, then at 9:00 am on August 1, 2017, the defendant shall surrender to the United States Marshal for this district.
 - as notified by the United States Marshal.
 - as notified by the Probation or Pretrial Services Office.

RETURN

I have executed this judgment as follows:

The Defendant delivered on _____ to _____ at
_____, with a certified copy of this judgment.

UNITED STATES MARSHAL

By _____
**DEPUTY UNITED
STATES MARSHAL**

SUPERVISED RELEASE

Upon release from imprisonment, the defendant shall be on supervised release for a term of: 3 years – This term consists of 3 years on Count 1, and 1 year on Counts 4, 5, & 6, all counts to be served concurrently

MANDATORY CONDITIONS OF SUPERVISION

- 1) You must not commit another federal, state or local crime.
- 2) You must not unlawfully possess a controlled substance.
- 3) You must refrain from any unlawful use of a controlled substance. You must submit to one drug test within 15 days of release from imprisonment and at least two periodic drug tests thereafter, as determined by the court.
 - The above drug testing condition is suspended, based on the court's determination that you pose a low risk of future substance abuse. *(check if applicable)*
- 4) You must cooperate in the collection of DNA as directed by the probation officer. *(check if applicable)*
- 5) You must comply with the requirements of the Sex Offender Registration and Notification Act (42 U.S.C. § 16901, et seq.) as directed by the probation officer, the Bureau of Prisons, or any state sex offender registration agency in which you reside, work, are a student, or were convicted of a qualifying offense. *(check if applicable)*

App. 12

6) You must participate in an approved program for domestic violence. (*check if applicable*)

You must comply with the standard conditions that have been adopted by this court as well as with any other conditions on the attached page.

STANDARD CONDITIONS OF SUPERVISION

As part of your supervised release, you must comply with the following standard conditions of supervision. These conditions are imposed because they establish the basic expectations for your behavior while on supervision and identify the minimum tools needed by probation officers to keep informed, report to the court, and bring about improvements in your conduct and condition.

- 1) You must report to the probation office in the federal judicial district where you are authorized to reside within 72 hours of RELEASE, unless the probation officer instructs you to report to a different probation office or within a different time frame.
- 2) After initially reporting to the probation office, you will receive instructions from the court or the probation officer about how and when you must report to the probation officer, and you must report to the probation officer as instructed.
- 3) You must not knowingly leave the federal judicial district where you are authorized to reside without first getting permission from the court or the probation officer.

App. 13

- 4) You must follow the instructions of the probation officer related to the conditions of supervision.
- 5) You must answer truthfully the questions asked by your probation officer.
- 6) You must live at a place approved by the probation officer. If you plan to change where you live or anything about your living arrangements (such as the people you live with, for example), you must notify the probation officer at least 10 days before the change. If notifying the probation officer in advance is not possible due to unanticipated circumstances, you must notify the probation officer within 72 hours of becoming aware of a change or expected change.
- 7) You must allow the probation officer to visit you at any time at your home or elsewhere, and you must permit the probation officer to take any items prohibited by these and the special conditions of your supervision that he or she observes in plain view.
- 8) You must work regularly at a lawful occupation, unless excused by the probation officer. If you plan to change where you work or anything about your work (such as your position or your job responsibilities), you must notify the probation officer at least 10 days before the change. If notifying the probation officer at least 10 days in advance is not possible due to unanticipated circumstances, you must notify the probation officer within 72 hours of becoming aware of a change or expected change.
- 9) You must not communicate or interact with someone you know is engaged in criminal activity. You must not associate, communicate, or interact with any person you know has been convicted of a

App. 14

felony, unless granted permission to do so by the probation officer.

- 10) If you are arrested or questioned by a law enforcement officer, you must notify the probation officer within 72 hours.
- 11) You must not act or make any agreement with a law enforcement agency to act as a confidential human source or informant without first getting the permission of the court.
- 12) You must not own, possess, or have access to a firearm, ammunition, destructive device, or dangerous weapon (i.e., anything that was designed, or was modified for, the specific purpose of causing bodily injury or death to another person such as nunchakus or tasers).

If the probation officer determines that you pose a risk to a third party, the probation officer may require you to notify the person about the risk and you must comply with that instruction. The probation officer may contact the person and confirm that you have notified the person about the risk.
(check if applicable)

U.S. Probation Office Use Only

A U.S. probation officer has instructed me on the conditions specified by the court and has provided me with a written copy of this judgment containing these conditions. I understand that the court may (1) revoke supervision, (2) extend the term of supervision, and/or

App. 15

(3) modify the conditions of supervision upon a finding of a violation of probation or supervised release.

(Signed)

Defendant _____ Date

U.S. Probation Officer/ _____ Date
Designated Witness

SPECIAL CONDITIONS OF SUPERVISION

1. The defendant shall pay any restitution, fine and special assessment that is imposed by this judgment and that remains unpaid at the commencement of the term of supervised release.
2. The defendant shall comply and cooperate with the IRS in a good-faith effort to pay any outstanding tax liability, to include any assessed penalty and interest.
3. The defendant shall provide the U.S. Probation Office with a copy of any written and approved agreement with the IRS for the payment of any outstanding tax liability, to include penalty and interest, within 10 days from the execution of such agreement.
4. The defendant shall timely and accurately file all future income tax returns required by law during the term of supervision, unless an extension of time is granted by the IRS.
5. The defendant shall not open any new lines of credit and/or incur new debt without the prior permission of the probation officer.

App. 16

6. The defendant shall provide the probation officer with access to any financial information, including tax returns, and shall authorize the probation officer to conduct credit checks and obtain copies of income tax returns.
7. The defendant shall participate in a mental health treatment program, as directed by the probation officer. The defendant is to pay part or all cost of this treatment, at an amount not to exceed the cost of treatment, as deemed appropriate by the probation officer. Payments shall never exceed the total cost of mental health counseling. The actual co-payment schedule shall be determined by the probation officer.
8. The defendant shall cooperate in the collection of DNA as directed by the probation officer.
9. The defendant shall not own or possess any firearms, ammunition, destructive devices, or other dangerous weapons.
10. The defendant shall submit his person, residence, office, vehicle, or any property under his control to a search. Such a search shall be conducted by a United States Probation Officer at a reasonable time and in a reasonable manner, based upon reasonable suspicion of contraband or evidence of a violation of a condition of release. Failure to submit to such a search may be grounds for revocation; the defendant shall warn any residents that the premises may be subject to searches.

CRIMINAL MONETARY PENALTIES

The defendant must pay the total criminal monetary penalties under the schedule of payments.

	<u>Assessment</u>	<u>Fine</u>	<u>Restitution</u>
TOTALS	\$ 400	\$ 75,000	\$ 396,306

- The determination of restitution is deferred until . An *Amended Judgment in a Criminal Case* (AO 245C) will be entered after such determination.
- The defendant must make restitution (including community restitution) to the following payees in the amount listed below.

If the defendant makes a partial payment, each payee shall receive an approximately proportioned payment, unless specified otherwise in the priority order or percentage payment column below. However, pursuant to 18 U.S.C. § 3664(i), all nonfederal victims must be paid before the United States is paid.

Name of Payee	Total Loss*	Restitution Ordered	Priority or Percentage
Internal Revenue Service IRS — RACS Attn: Mail Stop 6261, Restitution 333 W. Pershing Ave. Kansas City, MO 64108	\$747,233	\$396,306	

* Findings for the total amount of losses are required under Chapters 109A, 110, 110A, and 113A of Title 18 for offenses committed on or after September 13, 1994, but before April 23, 1996.

App. 18

TOTALS	\$ 747,233.00	\$ 396,306.00	

- Restitution amount ordered pursuant to plea agreement \$
- The defendant must pay interest on restitution and a fine of more than \$2,500, unless the restitution or fine is paid in full before the fifteenth day after the date of the judgment, pursuant to 18 U.S.C. § 3612(f). All of the payment options on Sheet 6 may be subject to penalties for delinquency and default, pursuant to 18 U.S.C. § 3612(g).
- The court determined that the defendant does not have the ability to pay interest and it is ordered that:
 - the interest requirement is waived for the .
 - the interest requirement is waived for the is modified as follows:

SCHEDULE OF PAYMENTS

Having assessed the defendant's ability to pay, payment of the total criminal monetary penalties is due as follows*:

* Payments shall be applied in the following order: (1) assessment, (2) restitution principal, (3) restitution interest, (4) fine principal, (5) fine interest, (6) community restitution, (7) penalties, and (8) costs, including cost of prosecution and court costs.

App. 19

A Lump sum payment of \$471,706.00 due immediately, balance due

not later than _____, or

in accordance with C, D, or E, and/or F below); or

B Payment to begin immediately (may be combined with C, D, or F below); or

C Payment in equal (e.g., weekly, monthly, quarterly) installments of _____ over a period of (e.g., months or years), to commence (e.g., 30 or 60 days) after the date of this judgment; or

D Payment in equal (e.g., weekly, monthly, quarterly) installments of _____ over a period of (e.g., months or years), to commence (e.g., 30 or 60 days) after release from imprisonment to a term of supervision; or

E Payment during the term of supervised release will commence within (e.g., 30 or 60 days) after release from imprisonment. The court will set the payment plan based on an assessment of the defendant's ability to pay at that time; or

F Special instructions regarding the payment of criminal monetary penalties:

When incarcerated, payment of criminal monetary penalties are due during imprisonment at the rate of not less than \$25 per quarter and payment shall be through the Bureau of Prisons Inmate Financial Responsibility Program. Once the defendant is on supervised release,

restitution must be paid in monthly payments of not less than \$100 or at least 10 percent of earnings, whichever is greater, to commence no later than 60 days from placement on supervision. Any established payment plan does not preclude enforcement efforts by the US Attorney's Office if the defendant has the ability to pay more than the minimum due.

Criminal monetary payments shall be made to the Clerk of U.S. District Court, 450 Golden Gate Ave., Box 36060, San Francisco, CA 94102.

Unless the court has expressly ordered otherwise, if this judgment imposes imprisonment, payment of criminal monetary penalties is due during imprisonment. All criminal monetary penalties, except those payments made through the Federal Bureau of Prisons' Inmate Financial Responsibility Program, are made to the clerk of the court.

The defendant shall receive credit for all payments previously made toward any criminal monetary penalties imposed.

Joint and Several

Case Number Defendant and Co-Defendant Names (including defendant number)	Total Amount	Joint and Several Amount	Corre- sponding Payee, if appropri- ate
Tracy Chang [sic] — 0971 CR-15- 00067-001 WHO	\$ 396,306.00	\$ 396,306.00	Internal Revenue Service

- The defendant shall pay the cost of prosecution: \$8,570.95
- The defendant shall pay the following court cost(s):
- The defendant shall forfeit the defendant's interest in the following property to the United States:
- The Court gives notice that this case involves other defendants who may be held jointly and severally liable for payment of all or part of the restitution ordered herein and may order such payment in the future, **but such future orders do not affect the defendant's responsibility for the full amount of the restitution ordered.**

**UNITED STATES DISTRICT COURT
Northern District of California**

**UNITED STATES) JUDGMENT IN A
OF AMERICA) CRIMINAL CASE**
v.) (Filed Jun. 2, 2017)
Tracy Chang) USDC Case Number:
) CR-15-00067-001 WHO
) BOP Case Number:
) DCAN315CR00067-001
) USM Number: 20383-111
) Defendant's Attorney:
) Joseph Cosmo Longo
) (Retained)

THE DEFENDANT:

- pleaded guilty to count(s): _____
- pleaded nolo contendere to count(s):_which was accepted by the court.
- was found guilty on counts: One and Two of the Indictment after a plea of not guilty

The defendant is adjudicated guilty of these offenses:

Title & Section	Nature of Offense	Offense Ended	Count
18 U.S.C. § 371	Conspiracy to Defraud the United States	March 1, 2011	1

App. 23

26 U.S.C. § 7206(1)	Making and Subscribing False Tax Return	December 28, 2010	2
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The defendant is sentenced as provided in pages 2 through 7 of this judgment. The sentence is imposed pursuant to the Sentencing Reform Act of 1984.

- The defendant has been found not guilty on count(s):
- Count(s) dismissed on the motion of the United States.

It is ordered that the defendant must notify the United States attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid. If ordered to pay restitution, the defendant must notify the court and United States attorney of material changes in economic circumstances.

5/26/2017

Date of Imposition of Judgment

William H. Orrick

Signature of Judge

The Honorable William H. Orrick III

United States District Judge

Name & Title of Judge

6/2/2017

Date

IMPRISONMENT

The defendant is hereby committed to the custody of the United States Bureau of Prisons to be imprisoned for a total term of:

12 months and one day – This term consists of 12 months and one day on each of Counts 1 & 2, to be served concurrently

The appearance bond is hereby exonerated, or upon surrender of the defendant as noted below. Any cash bail plus interest shall be returned to the owner(s) listed on the Affidavit of Owner of Cash Security form on file in the Clerk's Office.

- The court makes the following recommendations to the Bureau of Prisons:
The defendant be designated to FCI Dublin
- The defendant is remanded to the custody of the United States Marshal.
- The defendant shall surrender to the United States Marshal for this district:
 - at on (no later than 2:00 pm). .
 - as notified by the United States Marshal.
- The defendant shall surrender for service of sentence at the institution designated by the Bureau of Prisons:
 - at 9:00 am on August 1, 2017 (no later than 2:00 pm). If no facility has been assigned by the date of self-surrender, then at 9:00 am on August 1, 2017, the defendant shall surrender to the United States Marshal for this district.

App. 25

- as notified by the United States Marshal.
- as notified by the Probation or Pretrial Services Office.

RETURN

I have executed this judgment as follows:

The Defendant delivered on _____ to _____ at
_____, with a certified copy of this judgment.

UNITED STATES MARSHAL

By _____
**DEPUTY UNITED
STATES MARSHAL**

SUPERVISED RELEASE

Upon release from imprisonment, the defendant shall be on supervised release for a term of: 3 years – This term consists of 3 years on Count 1, and 1 year on Count 2, both counts to be served concurrently

MANDATORY CONDITIONS OF SUPERVISION

- 1) You must not commit another federal, state or local crime.
- 2) You must not unlawfully possess a controlled substance.
- 3) You must refrain from any unlawful use of a controlled substance. You must submit to one drug

App. 26

test within 15 days of release from imprisonment and at least two periodic drug tests thereafter, as determined by the court.

- The above drug testing condition is suspended, based on the court's determination that you pose a low risk of future substance abuse. *(check if applicable)*
- 4) You must cooperate in the collection of DNA as directed by the probation officer. *(check if applicable)*
- 5) You must comply with the requirements of the Sex Offender Registration and Notification Act (42 U.S.C. § 16901, et seq.) as directed by the probation officer, the Bureau of Prisons, or any state sex offender registration agency in which you reside, work, are a student, or were convicted of a qualifying offense. *(check if applicable)*
- 6) You must participate in an approved program for domestic violence. *(check if applicable)*

You must comply with the standard conditions that have been adopted by this court as well as with any other conditions on the attached page.

STANDARD CONDITIONS OF SUPERVISION

As part of your supervised release, you must comply with the following standard conditions of supervision. These conditions are imposed because they establish the basic expectations for your behavior while on supervision and identify the minimum tools needed by probation officers to keep informed, report to the court,

App. 27

and bring about improvements in your conduct and condition.

- 1) You must report to the probation office in the federal judicial district where you are authorized to reside within 72 hours of RELEASE, unless the probation officer instructs you to report to a different probation office or within a different time frame.
- 2) After initially reporting to the probation office, you will receive instructions from the court or the probation officer about how and when you must report to the probation officer, and you must report to the probation officer as instructed.
- 3) You must not knowingly leave the federal judicial district where you are authorized to reside without first getting permission from the court or the probation officer.
- 4) You must follow the instructions of the probation officer related to the conditions of supervision.
- 5) You must answer truthfully the questions asked by your probation officer.
- 6) You must live at a place approved by the probation officer. If you plan to change where you live or anything about your living arrangements (such as the people you live with, for example), you must notify the probation officer at least 10 days before the change. If notifying the probation officer in advance is not possible due to unanticipated circumstances, you must notify the probation officer within 72 hours of becoming aware of a change or expected change.

App. 28

- 7) You must allow the probation officer to visit you at any time at your home or elsewhere, and you must permit the probation officer to take any items prohibited by these and the special conditions of your supervision that he or she observes in plain view.
- 8) You must work regularly at a lawful occupation, unless excused by the probation officer. If you plan to change where you work or anything about your work (such as your position or your job responsibilities), you must notify the probation officer at least 10 days before the change. If notifying the probation officer at least 10 days in advance is not possible due to unanticipated circumstances, you must notify the probation officer within 72 hours of becoming aware of a change or expected change.
- 9) You must not communicate or interact with someone you know is engaged in criminal activity. You must not associate, communicate, or interact with any person you know has been convicted of a felony, unless granted permission to do so by the probation officer.
- 10) If you are arrested or questioned by a law enforcement officer, you must notify the probation officer within 72 hours.
- 11) You must not act or make any agreement with a law enforcement agency to act as a confidential human source or informant without first getting the permission of the court.
- 12) You must not own, possess, or have access to a firearm, ammunition, destructive device, or dangerous weapon (i.e., anything that was designed, or was modified for, the specific purpose of causing

App. 29

bodily injury or death to another person such as nunchakus or tasers).

- If the probation officer determines that you pose a risk to a third party, the probation officer may require you to notify the person about the risk and you must comply with that instruction. The probation officer may contact the person and confirm that you have notified the person about the risk.
(check if applicable)

U.S. Probation Office Use Only

A U.S. probation officer has instructed me on the conditions specified by the court and has provided me with a written copy of this judgment containing these conditions. I understand that the court may (1) revoke supervision, (2) extend the term of supervision, and/or (3) modify the conditions of supervision upon a finding of a violation of probation or supervised release.

(Signed)

Defendant _____ Date

U.S. Probation Officer/ _____ Date
Designated Witness

SPECIAL CONDITIONS OF SUPERVISION

1. The defendant shall pay any restitution, fine and special assessment that is imposed by this judgment and that remains unpaid at the commencement of the term of supervised release.

App. 30

2. The defendant shall comply and cooperate with the IRS in a good-faith effort to pay any outstanding tax liability, to include any assessed penalty and interest.
3. The defendant shall provide the U.S. Probation Office with a copy of any written and approved agreement with the IRS for the payment of any outstanding tax liability, to include penalty and interest, within 10 days from the execution of such agreement.
4. The defendant shall timely and accurately file all future income tax returns required by law during the term of supervision, unless an extension of time is granted by the IRS.
5. The defendant shall not open any new lines of credit and/or incur new debt without the prior permission of the probation officer.
6. The defendant shall provide the probation officer with access to any financial information, including tax returns, and shall authorize the probation officer to conduct credit checks and obtain copies of income tax returns.
7. The defendant shall participate in a mental health treatment program, as directed by the probation officer. The defendant is to pay part or all cost of this treatment, at an amount not to exceed the cost of treatment, as deemed appropriate by the probation officer. Payments shall never exceed the total cost of mental health counseling. The actual co-payment schedule shall be determined by the probation officer.

App. 31

8. The defendant shall cooperate in the collection of DNA as directed by the probation officer.
9. The defendant shall not own or possess any firearms, ammunition, destructive devices, or other dangerous weapons.
10. The defendant shall submit her person, residence, office, vehicle, or any property under her control to a search. Such a search shall be conducted by a United States Probation Officer at a reasonable time and in a reasonable manner, based upon reasonable suspicion of contraband or evidence of a violation of a condition of release. Failure to submit to such a search may be grounds for revocation; the defendant shall warn any residents that the premises may be subject to searches.

CRIMINAL MONETARY PENALTIES

The defendant must pay the total criminal monetary penalties under the schedule of payments.

	<u>Assessment</u>	<u>Fine</u>	<u>Restitution</u>
TOTALS	\$ 200	\$ 7,500	\$ 396,306

The determination of restitution is deferred until . An *Amended Judgment in a Criminal Case* (AO 245C) will be entered after such determination.

The defendant must make restitution (including community restitution) to the following payees in the amount listed below.

If the defendant makes a partial payment, each payee shall receive an approximately

App. 32

proportioned payment, unless specified otherwise in the priority order or percentage payment column below. However, pursuant to 18 U.S.C. § 3664(i), all nonfederal victims must be paid before the United States is paid.

Name of Payee	Total Loss*	Restitution Ordered	Priority or Percentage
Internal Revenue Service IRS — RACS Attn: Mail Stop 6261, Restitution 333 W. Pershing Ave. Kansas City, MO 64108	\$747,233	\$396,306	
TOTALS	\$747,233.00	\$ 396,306.00	

- Restitution amount ordered pursuant to plea agreement \$
- The defendant must pay interest on restitution and a fine of more than \$2,500, unless the restitution or fine is paid in full before the fifteenth day after the date of the judgment, pursuant to 18 U.S.C. § 3612(f). All of the payment options on Sheet 6 may be subject to penalties for delinquency and default, pursuant to 18 U.S.C. § 3612(g).

* Findings for the total amount of losses are required under Chapters 109A, 110, 110A, and 113A of Title 18 for offenses committed on or after September 13, 1994, but before April 23, 1996.

- The court determined that the defendant does not have the ability to pay interest and it is ordered that:
 - the interest requirement is waived for the .
 - the interest requirement is waived for the is modified as follows:

SCHEDE OF PAYMENTS

Having assessed the defendant's ability to pay, payment of the total criminal monetary penalties is due as follows*:

- A** Lump sum payment of \$404,006 due immediately, balance due
 - not later than , or
 - in accordance with C, D, or E, and/or F below); or
- B** Payment to begin immediately (may be combined with C, D, or F below); or
- C** Payment in equal (e.g., weekly, monthly, quarterly) installments of _ over a period of (e.g., months or years), to commence (e.g., 30 or 60 days) after the date of this judgment; or
- D** Payment in equal (e.g., weekly, monthly, quarterly) installments of _ over a period of (e.g.,

* Payments shall be applied in the following order: (1) assessment, (2) restitution principal, (3) restitution interest, (4) fine principal, (5) fine interest, (6) community restitution, (7) penalties, and (8) costs, including cost of prosecution and court costs.

App. 34

months or years), to commence (e.g., 30 or 60 days) after release from imprisonment to a term of supervision; or

- E** Payment during the term of supervised release will commence within (e.g., 30 or 60 days) after release from imprisonment. The court will set the payment plan based on an assessment of the defendant's ability to pay at that time; or
- F** Special instructions regarding the payment of criminal monetary penalties:

When incarcerated, payment of criminal monetary penalties are due during imprisonment at the rate of not less than \$25 per quarter and payment shall be through the Bureau of Prisons Inmate Financial Responsibility Program. Once the defendant is on supervised release, restitution must be paid in monthly payments of not less than \$100 or at least 10 percent of earnings, whichever is greater, to commence no later than 60 days from placement on supervision. Any established payment plan does not preclude enforcement efforts by the US Attorney's Office if the defendant has the ability to pay more than the minimum due.

Criminal monetary payments shall be made to the Clerk of U.S. District Court, 450 Golden Gate Ave., Box 36060, San Francisco, CA 94102.

App. 35

Unless the court has expressly ordered otherwise, if this judgment imposes imprisonment, payment of criminal monetary penalties is due during imprisonment. All criminal monetary penalties, except those payments made through the Federal Bureau of Prisons' Inmate Financial Responsibility Program, are made to the clerk of the court.

The defendant shall receive credit for all payments previously made toward any criminal monetary penalties imposed.

Joint and Several

Case Number Defendant and Co-Defendant Names (including defendant number)	Total Amount	Joint and Several Amount	Corre- sponding Payee, if appropri- ate
Howard [sic] Hsu — 0971 CR-15- 00067-002 WHO	\$ 396,306.00	\$ 396,306.00	Internal Revenue Service

- The defendant shall pay the cost of prosecution: \$8,570.95
- The defendant shall pay the following court cost(s):
- The defendant shall forfeit the defendant's interest in the following property to the United States:
- The Court gives notice that this case involves other defendants who may be held jointly and severally liable for payment of all or part of the restitution ordered herein and may order such payment

in the future, but such future orders do not affect the defendant's responsibility for the full amount of the restitution ordered.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA,	Case No. 15-cr-00067- WHO-1
Plaintiff,	ORDER ON MOTION TO SUPPRESS
v.	(Filed Sep. 1, 2016)
TRACY CHANG and HOWARD HSU,	Re: Dkt. No. 58
Defendants.	

INTRODUCTION

This is a tax evasion prosecution. Defendants Tracy Chang and Howard Hsu move to suppress evidence obtained pursuant to a search warrant for Chang's residence at 3435 Clement Street, San Francisco. They also seek a *Franks* hearing based on two alleged misrepresentations in the warrant affidavit. In the alternative, they move under Federal Rules of Evidence 402 and 403 to exclude all "personal emails" seized during the search. Hsu lacks standing to challenge the search of his mother's residence. Probable cause supports the search warrant, although some of the categories sought were overbroad. Accordingly, evidence pertaining to categories 4, 6, 10, 16, 18, and 20 of the search warrant, as well as evidence not pertaining to the time period December 2006 to January 2010, is suppressed as to Chang. In all other respects, defendants' motion is DENIED.

BACKGROUND

Tracy Chang is the mother of Howard Hsu. Chang and Hsu are charged with conspiracy to defraud the United States in violation of 18 U.S.C. § 371¹ based on the allegedly false tax returns of the Didsee Corporation (“Didsee”). Indictment ¶¶ 2-18 (Dkt. No. 1). According to the indictment, Chang established Didsee and served as its President, Secretary, Treasurer, Director, bookkeeper, and accountant. *Id.* ¶ 4. The indictment describes Hsu as Didsee’s owner and operator. *Id.* ¶ 3. In addition to 18 U.S.C. § 371, the indictment charges Chang with two counts of making and subscribing false tax returns in violation of 26 U.S.C. § 7206(1), and Hsu with three counts of aiding and assisting in the preparation of false tax returns in violation of 26 U.S.C. § 7206(2).² *Id.* ¶¶ 21-28.

¹ “If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both.” 18 U.S.C. § 371.

² 26 U.S.C. § 7206, subsections (1) and (2), provide as follows: Any person who

- (1) Declaration under penalties of perjury. Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; or
- (2) Aid or assistance. Willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter

On March 22, 2011, IRS Special Agent Adam Gray executed a search warrant for Chang's residence located at 3435 Clement Street, San Francisco, California. *See Search Warrant* at p.9-10 (Longo Decl. Ex. E, Dkt. No. 58-6). He seized business and financial records, tax documents, and computer hardware and software. *See id.* The warrant was signed by Magistrate Judge Spero on March 18, 2011 based on a warrant affidavit submitted by IRS Special Agent Justin Fletcher. Longo Decl. Ex. A (Dkt. No. 58-2) ("Warrant Affidavit").

Defendants seek to suppress all evidence obtained pursuant to the warrant. Dkt. No. 58 ("Mot."). The government filed its opposition on August 11, 2016. Dkt. No. 60 ("Oppo."). Defendants did not file a reply. I heard argument from the parties on August 18, 2016. Dkt. No. 64.

LEGAL STANDARD

The Fourth Amendment protects against unreasonable searches and seizures and requires that warrants be issued only upon a showing of probable cause. U.S. Const. Amend. IV ("The right of the people to be

arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document . . .

[. . .]

shall be guilty of a felony.

26 U.S.C. § 7206.

secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.”). Searches and seizures in violation of the Fourth Amendment are unlawful, and evidence obtained as a result is considered “fruit of the poisonous tree” and is inadmissible under the exclusionary rule. *United States v. McClendon*, 713 F.3d 1211, 1215 (9th Cir. 2013); *see also United States v. Underwood*, 725 F.3d 1076, 1083-84 (9th Cir. 2013).

DISCUSSION

I. HSU’S STANDING TO CHALLENGE THE SEARCH

The government contends that Hsu lacks Fourth Amendment standing to challenge the search given that he did not reside at 3435 Clement Street, was not present when the search occurred, and has not identified any other basis for finding that he had a reasonable expectation of privacy in his mother’s residence. Oppo. at 5-7.

It is well established that “Fourth Amendment rights are personal rights which, like some other constitutional rights, may not be vicariously asserted.” *Al-derman v. United States*, 394 U.S. 165, 174 (1969). “In order to qualify as a ‘person aggrieved by an unlawful search and seizure’ one must have been a victim of a search or seizure, . . . as distinguished from one who

claims prejudice only through the use of evidence gathered as a consequence of a search or seizure directed at someone else.” *Id.* at 173. “[T]he application of the Fourth Amendment depends on whether the person invoking its protection can claim a ‘justifiable,’ a ‘reasonable,’ or a ‘legitimate expectation of privacy’ that has been invaded by government action.” *Smith v. Maryland*, 442 U.S. 735, 740 (1979). The burden is on the person moving to suppress to make this showing. *United States v. Caymen*, 404 F.3d 1196, 1199-1200 (9th Cir. 2005). “A person demonstrates a legitimate expectation of privacy when that person has a (1) subjective expectation of privacy, and (2) an objectively reasonable expectation of privacy.” *United States v. Shryock*, 342 F.3d 948, 978 (9th Cir. 2003).

Hsu has not shown that he had a reasonable expectation of privacy in his mother’s residence. It is undisputed that he did not reside there and was not present at the time of the search. He identifies no ownership rights in his mother’s residence, nor any level of control or supervision over it. *Cf Lyall v. City of Los Angeles*, 807 F.3d 1178, 1186-87 (9th Cir. 2015) (“To be shielded by the Fourth Amendment, a person needs some joint control and supervision of the place searched, not merely permission to be there.”) (internal quotation marks omitted). Indeed, as the government raised the Fourth Amendment standing issue in its opposition brief and defendants did not file a reply, Hsu did not address this issue at all until the hearing. There, his counsel argued briefly that he has standing to challenge the search because he “had both papers

and effects at the house,” and because he “grew up in [the] house” and “still to this day has a bedroom in [the] house, which he [uses] from time to time.” Hsu’s counsel did not identify any specific papers or effects of his that were at the house (except for the personal email discussed in more detail below), or provide any additional details regarding Hsu’s use of his bedroom at the house. Based on the record before me, I agree with the government that Hsu has not established Fourth Amendment standing to challenge the search of 3435 Clement Street. Further, even if Hsu could challenge the search, he would not be entitled to suppression of all evidence seized for the reasons stated below.

II. SUFFICIENCY OF THE WARRANT AFFIDAVIT AND SEARCH WARRANT

A. Probable Cause

Defendants contend that the warrant affidavit lacked sufficient facts to establish probable cause to believe either (1) that they had committed any crimes at all, or (2) that evidence of those crimes could be found at Chang’s residence. Mot. at 4-5.

“A search warrant is supported by probable cause if the issuing judge finds that, given all the circumstances set forth in the affidavit before him[,] there is a fair probability that contraband or evidence of a crime will be found in a particular place.” *Underwood*, 725 F.3d at 1081 (internal quotation marks omitted). This standard does not require the affidavit to establish that the evidence is in fact in the place to be

App. 43

searched, or that it is more likely than not to be found there. *United States v. Fernandez*, 388 F.3d 1199, 1254 (9th Cir. 2004). Rather, the issuing judge “need only conclude that it would be reasonable to seek the evidence in the place indicated in the affidavit.” *Id.* (internal quotation marks omitted). An issuing judge’s finding of probable cause is entitled to “great deference” and is reviewed only for “clear error.” *United States v. Krupa*, 658 F.3d 1174, 1177 (9th Cir. 2011). Nevertheless, a reviewing court should find that a warrant is unsupported by probable cause where “the issuing judge lacked a substantial basis for concluding that probable cause existed.” *Underwood*, 725 F.3d at 1081 (internal quotation marks and alterations omitted).

The warrant affidavit alleged that Chang had committed tax evasion by failing to report all of the income earned by Didsee and by failing to report personal benefits she derived from Didsee. Warrant Affidavit ¶¶ 2-4. It also alleged that she and Hsu had conspired to commit tax evasion on certain income earned by him. *Id.*

The affidavit included sufficient facts to provide a substantial basis for concluding that Chang and Hsu had committed these crimes. Among other facts, the affidavit stated that according to IRS records, Didsee (1) filed a 2007 tax return reporting \$1,653,511 in gross receipts; (2) did not file a 2008 tax return; and (3) filed a 2009 tax return reporting no gross receipts. Warrant Affidavit ¶¶ 35-37. The affidavit then stated,

App. 44

By comparing the IRS account history for DIDSEE with the banking activity observed in DIDSEE'S Cathay Bank account, it appears that a substantial portion of gross receipts were not reported to the IRS. From 2007 until January 2009, there has been approximately \$3,334,255.83 of deposits into DIDSEE's Cathay Bank account made by electronic deposits from three different companies. However, only \$1,653,511 in gross receipts has been reported to the IRS.

Id. ¶ 38.

The affidavit also included an analysis of two money market accounts at Western Pacific Bank in the names of "Chun Der Chang" and "Ching Shih Chang," both of whom listed 3435 Clement Street as their address when opening their accounts. *Id.* ¶¶ 21-25. The affidavit stated that Chang had power of attorney over these accounts, and that substantial deposits were made into the accounts from checks issued out of Didsee's Cathay Bank account. *Id.* The affidavit further stated that some of the deposits were followed by electronic transfers from the accounts into Chang's personal Western Pacific Bank account. *Id.*

In addition, the affidavit described payments made to American Express from Didsee's Cathay Bank account and Chang's personal Western Pacific Bank account for an American Express account held in Chang's name. The payments totaled \$41,171.57 in 2007 and \$145,136.67 in 2008. *Id.* ¶ 30. Despite the deposits from the "Chun Der Chang" and "Ching Shih

App. 45

Chang” accounts and the payments to American Express, Chang reported less than \$40,000 in total earnings each year in 2007 and 2008. *Id.* ¶ 34.

Finally, with respect to the alleged conspiracy between Chang and Hsu to commit tax evasion, the affidavit described four checks totaling \$254,725.38 that were made payable to Hsu in 2007 and that were then used to purchase cashier’s checks, in the exact same amounts as the original checks, made payable to Chang. *Id.* ¶¶ 39-40. The affidavit indicated that neither Chang nor Hsu had reported income on that scale in their 2007 tax returns.

These facts were sufficient to support a reasonable inference that Chang and Hsu had committed and conspired to commit tax evasion

The affidavit also provided a sufficient basis to believe that evidence of Chang and Hsu’s crimes would be found at 3435 Clement Street. Defendants assert that “the only connection [to] Chang’s residence [stated in the affidavit] is an uncorroborated opinion of Special Agent Fletcher that ‘from training and experience, and the experience of other Special Agents with whom I work, . . . records [of financial crimes] are commonly kept in the residence or business location(s) of the individuals committing the offense.’” Mot. at 4-5 (quoting Warrant Affidavit ¶ 13). This argument ignores several facts included in the affidavit. For example, the affidavit stated that Didsee’s bank statements were addressed to 3435 Clement Street despite Didsee’s address being listed as 5348 Vegas Drive, Las Vegas.

Warrant Affidavit ¶ 18. It also stated that “Chun Der Chang” and “Ching Shih Chang” both listed 3435 Clement Street as their address when opening their accounts. *Id.* ¶¶ 21-22. Magistrate Judge Spero did not clearly err in determining that there was probable cause to search Chang’s residence.

B. Specificity

Defendants also challenge the specificity of the search warrant. “Specificity has two aspects: particularity and breadth.” *In re Grand Jury Subpoenas Dated Dec. 10, 1987*, 926 F.2d 847, 856-57 (9th Cir. 1991). “Particularity is the requirement that the warrant must clearly state what is sought.” *Id.* “Breadth [is] the requirement that the scope of the warrant be limited by the probable cause on which the warrant is based.” *Id.*; see also *United States v. SDI Future Health, Inc.*, 568 F.3d 684, 702 (9th Cir. 2009) (“A warrant must not only give clear instructions to a search team, it must also give legal, that is, not overbroad, instructions.”). Unlike the issuing judge’s probable cause determination, the specificity of a search warrant is reviewed de novo. *United States v. Wong*, 334 F.3d 831, 836-37 (9th Cir. 2003).

While defendants’ specificity challenge touches on particularity, it is best characterized as an overbreadth challenge. See Mot. at 6-10. Defendants assert that the warrant improperly authorized a “generalized seizure of business and personal documents.” *Id.* at 8-9. Of the 20 categories of evidence identified for seizure in the

App. 47

warrant, defendants specifically identify three that they contend were beyond the scope of any probable cause determination: (1) “[a]ny passwords, password files, test keys, encryption codes or other information necessary to access the computer equipment. storage devices or data necessary to access the computer equipment, storage devices or data,” Search Warrant Attachment B ¶ 16 (Longo Decl. Ex. E, Dkt. No. 58-6); (2) “all instruction[s] or programs in the form of electronic or magnetic media which are capable of being interpreted by a computer or related components,” *id.* ¶ 18; and (3) “all stored electronic data that might help identify who was using a computer at a particular time, such as records of internet activity (use of and log ins to email, financial, or other websites) and other user-inputted data,” *id.* ¶ 20. As an example of the overbreadth of the third of these categories, defendants submit an allegedly improperly seized email they describe as “concerning a purely personal and private dispute between [Chang] and [Hsu].” Mot. at 10; *see also* Longo Decl. Ex. F (Dkt. No. 58-7).

Based on the 20 categories identified for seizure in the warrant, defendants liken this case to *United States v. Kow*, 58 F.3d 423 (9th Cir. 1995). There, the Ninth Circuit held that a search warrant for defendants’ place of business, HK Video, was insufficiently specific where it identified for seizure 14 categories of evidence without any significant limitations on the items to be seized. The Ninth Circuit reasoned that the warrant

App. 48

authorized the seizure of virtually every document and computer file at HK Video. To the extent that it provided any guidance to the officers executing the warrant, the warrant apparently sought to describe every document on the premises and direct that everything be seized. The government emphasizes that the warrant outlined fourteen separate categories of business records. However, the warrant contained no limitations on which documents within each category could be seized or suggested how they related to specific criminal activity. By failing to describe with any particularity the items to be seized, the warrant is indistinguishable from the general warrants repeatedly held by this court to be unconstitutional.

Generic classifications in a warrant are acceptable only when a more precise description is not possible. The government could have made the warrant more particular. Most obviously, the warrant could have specified the suspected criminal conduct. Except for vague references to "fraudulent" transactions and possible disparities between actual and reported income, the warrant failed to give any indication of the alleged crime to which the seized documents pertained. We have criticized repeatedly the failure to describe in a warrant the specific criminal activity suspected.

The government did not limit the scope of the seizure to a time frame within which the suspected criminal activity took place, even

though [the warrant] affidavit indicates that the alleged criminal activity began relatively late in HK Video's existence. Furthermore, although [the warrant] affidavit summarized in detail the various locations within HK Video where officers could find relevant documents, this information was excluded from the warrant. Here the government did not contain the scope of the warrant by reference to limiting descriptions in the affidavit such as HK Video's tax identification number, HK Video's [bank] account number . . . , or the names of the foreign companies allegedly receiving the proceeds of the defendants' profit skimming . . . As drafted, the warrant simply was not sufficiently particular.

Id. at 427 (internal quotation marks, citations, and alterations omitted).

Kow relied in part on *United States v. Stubbs*, 873 F.2d 210 (9th Cir. 1989), in which the Ninth Circuit affirmed the suppression of evidence seized pursuant to a search warrant obtained by the IRS. The warrant in *Stubbs* authorized the seizure of

[a]ccounts and business records from May, 1977, through May, 1984 relating to: master cash receipts and disbursements journals; rental commission ledgers; general ledgers; check books; closed escrow logs; closed escrow files; cancelled checks and check stubs thereto; bank statements; deposit slips; cashier check receipts; cancelled trust account checks and check stubs thereof; credit card sales receipts and statements; trust deeds,

notes, and copies thereof made out to DAVID STUBBS' father, JACKSON STUBBS; cancelled checks for maintenance fees and check stubs thereto; 3 x 5 card file box containing cards with financial account numbers, their locations, and other account information of DAVE STUBBS REAL ESTATE, INC. and DAVE STUBBS; records of interest earned from trust funds; records of health insurance plans including but not limited to employee pay stubs, cancelled checks to health insurance plan organizations and check stubs thereto, and health insurance ledgers and statements for DAVE STUBBS REAL ESTATE, INC. and DAVE STUBBS.

Id. at 212. The court observed that the warrant "contained no reference to any criminal activity" and "merely described broad classes of documents." *Id.* Further, while "[t]he IRS knew both what the seizable documents looked like and where to find them, . . . this information was not contained in the warrant." *Id.* at 211.

The government responds that here, unlike in *Kow and Stubbs*, the 20 categories listed in the warrant did not stand alone, but were limited by the opening paragraph of attachment B to the warrant, which provided,

The property sought to be seized is limited to the records, documents, and items described below including the time period December 2006 until January 2010 belonging to, pertaining to, or referring to any of the [sic] following persons, entities, or addresses (including any

variation in spelling or initials of the individuals and entities listed below):

- a. Tracy Chang
- b. John Hsu
- c. Howard Hsu
- d. Lydia Vanmonyra Krin
- e. Chun-Der Chang
- f. Ching Shih Chang
- g. Didsee Corporation
- h. 3435 Clement St., San Francisco, California
- i. P.O. Box 591472, San Francisco, California
- j. 5348 Vegas Dr., Las Vegas, Nevada

Search Warrant Attachment B. The government argues that “[b]ecause the categories . . . were limited by both a thirty-eight month time restriction and a list of ten individuals, entities, and addresses, the search warrant was sufficiently specific to guide the seizing agents.” Oppo. at 16.

To the extent that the government means to argue that the opening paragraph of attachment B saves all of the 20 categories listed in the warrant, the argument fails. Apart from pointing to the opening paragraph, the government makes no attempt to defend the scope of any of the 20 categories. To the contrary, instead of explaining how the three allegedly overbroad categories identified by defendants were within the scope of the probable cause determination, the government asserts that it is “unaware of any such evidence that was seized in this case.” Oppo. at 16. Further, while the opening paragraph placed some limitations on the

App. 52

scope of the warrant by including a date range and listing the individuals, entities, and addresses suspected to be involved in the alleged crimes, the opening paragraph did not identify what those alleged crimes were.³ The government identifies no portion of the warrant that included this information. Nor does the government contend that the warrant affidavit should be incorporated by reference into the warrant. *See Future Health*, 568 F.3d at 699 (“We consider an affidavit to be part of a warrant, and therefore potentially curative of any defects, only if (1) the warrant expressly incorporated the affidavit by reference and (2) the affidavit either is attached physically to the warrant or at least accompanies the warrant while agents execute the search.”) (internal quotation marks omitted).

On the other hand, defendants identify only the three allegedly overbroad categories; apart from arguing generally that the warrant as a whole was defective under *Kow*, defendants identify no other categories as overbroad, much less explain why they are properly characterized as such. *See* Mot. at 6-10.

Having reviewed the warrant, I find that categories 4, 6, and 10 are overbroad.⁴ In light of the

³ In addition, while the opening paragraph included a date range, it did so with clumsy language that could have been read to either (1) limit the items to be seized to the time period December 2006 until January 2010, or (2) specify that items to be seized should include *at least* the time period December 2006 until January 2010. *See* Search Warrant Attachment B.

⁴ These categories provide as follows:

App. 53

government's failure to offer any counterargument, I also find that the categories identified by defendants are overbroad, i.e., categories 16, 18, and 20. In addition, I find that the scope of the warrant must be limited to the time period stated in the opening paragraph of attachment B, i.e., December 2006 to January 2010. In all other respects, however, I find that the warrant was sufficiently specific.

This raises the question of the appropriate remedy – total suppression, or severance and partial suppression. *See Future Health*, 568 F.3d at 706-7 (after “conclud[ing] that five of the twenty-four categories of materials listed in the search warrant were unconstitutionally overbroad,” turning to the question of “whether the district court was correct to suppress all the evidence obtained in the search, as opposed to severing violative portions of the warrant from the valid ones, and suppressing only the evidence obtained pursuant to the former”).

In general, total suppression is the appropriate remedy where “the valid portion of the warrant is a

- 4. Calendar book, daily planner, and personal organizers recording business contacts, associates, and information.
- 6. Documentation showing the names, addresses, and or telephone numbers for customers.
- 10. Correspondence and notes, in both electronic (email) and physical form, with customers, employees, and suppliers.

Search Warrant Attachment B ¶¶ 4, 6, 10. The government states that the personal email submitted by defendants was seized pursuant to category 10. Oppo. at 17.

relatively insignificant part of an otherwise invalid search.” *Id.* at 707 (internal quotation marks omitted). By contrast, where the violative portions of the warrant “concerned only a specific subset of items . . . and the lion’s share of the categories did not violate the Fourth Amendment,” partial suppression is required. *Id.*

Under this framework, the appropriate remedy here is clearly partial suppression. This is not a case where “nearly all the categories of items to be seized were defective” or where “the officers, in effect, conducted a warrantless search.” *Id.* (internal quotation marks omitted). It is one where the defective categories concerned “only a specific subset of items . . . and the lion’s share of the categories did not violate the Fourth Amendment.” *Id.* Accordingly, evidence pertaining to categories 4, 6, 10, 16, 18, and 20, as well as evidence not pertaining to the time period December 2006 to January 2010, is suppressed as to Chang. In all other respects, defendants’ motion to suppress is DENIED.

III. FRANKS HEARING

A defendant is entitled to hearing pursuant to *Franks v. Delaware*, 438 U.S. 154 (1978), only upon a showing of (1) intentional or reckless inclusion or omission and (2) materiality. *United States v. Bennett*, 219 F.3d 1117, 1124 (9th Cir. 2000). With respect to the intentional or reckless requirement, “[a]llegations that the affiant negligently or innocently included false

information are insufficient to require a *Franks* hearing.” *United States v. Staves*, 383 F.3d 977, 983 (9th Cir. 2004). With respect to materiality, the defendant must show that “the affidavit purged of its falsities would not be sufficient to support a finding of probable cause.” *Bennett*, 219 F.3d at 1124 (internal quotation marks omitted).

Defendants identify two alleged misrepresentations in the warrant affidavit. The first is in paragraph 17, which states, “Chang lists her occupation as an accountant at Golden Gate University.” Warrant Affidavit ¶ 17. Defendants contend that this statement is false because Chang has never been employed as an accountant. Mot. at 11. They further assert that “any minute investigatory effort on the part of Special Agent Fletcher would have apprised him of his error.” *Id.*

Defendants have not shown that paragraph 17 contains an intentionally or recklessly false statement. Special Agent Fletcher submits a declaration along with the government’s opposition brief in which he states that before signing the warrant affidavit, he received one report from Cathay Bank stating that “Tracy Chang . . . is an accountant at Golden Gate University,” and another report from Western Pacific Bank stating that when Chang opened her personal account there, she “listed her occupation as an accountant for Golden Gate University.” Fletcher Decl. ¶¶ 13-14 (Dkt. No. 61). Special Agent Fletcher also knew when signing the warrant affidavit that Chang had listed her occupation as “Accounts Payable” in her tax returns.

Warrant Affidavit ¶ 33. Further, according to the notes of the IRS agents who conducted the interviews, both Howard Hsu and John Hsu (Chang’s husband) described Chang as an accountant. Fletcher Decl. ¶ 15. Even assuming that Special Agent Fletcher was wrong to state that Chang “lists her occupation as an accountant at Golden Gate University,” he did not act intentionally or recklessly in stating it.

The other alleged misrepresentation identified by defendants is Special Agent Fletcher’s assertion that Didsee did not file a 2008 tax return. *See* Warrant Affidavit ¶ 36. It is now undisputed that Didsee filed a 2008 tax return on or around January 3, 2011, well before Special Agent Fletcher signed the warrant affidavit on March 18, 2011. According to Special Agent Fletcher’s declaration, however, given the procedures by which tax returns are uploaded into the IRS’s Integrated Data Retrieval System (“IDRS”), the existence of Didsee’s 2008 tax return would not have been apparent by IDRS search until May 2, 2011.⁵ Fletcher Decl. ¶¶ 10-11. Special Agent Fletcher also notes that, while the last time he checked IDRS for Didsee’s 2008 tax return was on December 14, 2010, by that time the tax return was already nearly fifteen months past due according to the extended deadline. *Id.* ¶¶ 7-8.

⁵ In the warrant affidavit, Special Agent Fletcher begins his discussion of Didsee’s tax returns with the phrase, “The IDRS account history for Didsee’s 2007 tax return indicates that . . . ” Warrant Affidavit ¶ 35. He then begins the paragraph with the alleged misrepresentation with the phrase, “Didsee’s 2008 account history indicates that . . . ” *Id.* ¶ 36.

Defendants present no competing evidence. Based on the record before me, I agree with the government that Special Agent Fletcher's statement that Didsee did not file a 2008 tax return was not intentionally or recklessly false. Defendants are not entitled to a *Franks* hearing.

IV. RULE 402 AND 403 OBJECTIONS

In the alternative, defendants assert that all "personal emails" seized from Chang's residence should be excluded under Federal Rules of Evidence 402 and 403. Mot. at 12-15. The only such email identified by defendants is the one between Chang and Hsu discussed above, which is suppressed as to Chang because it was seized pursuant to category 10 of the search warrant, and is excluded as to Hsu because it is irrelevant and unduly prejudicial. In light of defendants' failure to specify what other evidence they wish to exclude under Rules 402 and 403, the rest of this request is DENIED WITHOUT PREJUDICE to being raised again in connection with their pretrial materials.

CONCLUSION

Defendants' motion is GRANTED IN PART and DENIED IN PART as stated above.

IT IS SO ORDERED.

App. 58

Dated: September 1, 2016

/s/ William H. Orrick
WILLIAM H. ORRICK
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, Plaintiff-Appellee, v. TRACY CHANG Defendant-Appellant.	No. 17-10250 D.C. No. 3:15-cr-00067-WHO-1 Northern District of California, San Francisco ORDER (Filed Sep. 5, 2018)
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UNITED STATES OF AMERICA, Plaintiff-Appellee, v. HOWARD HSU, Defendant-Appellant.	No. 17-10256 D.C. No. 3:15-cr-00067-WHO-2
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Before: GRABER and TALLMAN, Circuit Judges, and
LEMELLE,* District Judge.

The panel has voted to deny Appellants' petition
for panel rehearing. Judge Graber has voted to deny

* The Honorable Ivan L.R. Lemelle, United States District Judge for the Eastern District of Louisiana, sitting by designation.

App. 60

Appellants' petition for rehearing en banc, and Judges Tallman and Lemelle have so recommended.

The full court has been advised of the petition for rehearing en banc, and no judge of the court has requested a vote on it.

Appellants' petition for panel rehearing and rehearing en banc is DENIED.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

UNITED STATES
OF AMERICA,
Plaintiff,
v.
TRACY CHANG and
HOWARD HSU,
Defendants.

Case No.: 3:15-cr-00067-
WHO
JURY INSTRUCTIONS
(Filed Feb. 13, 2017)

Duties of Jury to Find Facts and Follow Law

Members of the jury, now that you have heard all the evidence, it is my duty to instruct you on the law that applies to this case. A copy of these instructions will be available in the jury room for you to consult.

It is your duty to weigh and to evaluate all the evidence received in the case and, in that process, to decide the facts. It is also your duty to apply the law as I give it to you to the facts as you find them, whether you agree with the law or not. You must decide the case solely on the evidence and the law and must not be influenced by any personal likes or dislikes, opinions, prejudices, or sympathy. You will recall that you took an oath promising to do so at the beginning of the case.

You must follow all these instructions and not single out some and ignore others; they are all important. Please do not read into these instructions or into

anything I may have said or done any suggestion as to what verdict you should return—that is a matter entirely up to you.

**Charge Against Defendant Not Evidence—
Presumption of Innocence—Burden of Proof**

The indictment is not evidence. The defendant has pleaded not guilty to the charges. The defendant is presumed to be innocent unless and until the government proves the defendant guilty beyond a reasonable doubt. In addition, the defendant does not have to testify or present any evidence to prove innocence. The government has the burden of proving every element of the charges beyond a reasonable doubt.

Defendant's Decision Not to Testify

A defendant in a criminal case has a constitutional right not to testify. You may not draw any inference of any kind from the fact that the defendant did not testify.

Right to a Court-Appointed Interpreter

A defendant in a criminal case has the right to a court-appointed interpreter when her comprehension of the proceedings or ability to communicate with counsel is impaired.

Reasonable Doubt-Defined

Proof beyond a reasonable doubt is proof that leaves you firmly convinced the defendant is guilty. It is not required that the government prove guilt beyond all possible doubt.

A reasonable doubt is a doubt based upon reason and common sense and is not based purely on speculation. It may arise from a careful and impartial consideration of all the evidence, or from lack of evidence.

If after a careful and impartial consideration of all the evidence, you are not convinced beyond a reasonable doubt that the defendant is guilty, it is your duty to find the defendant not guilty. On the other hand, if after a careful and impartial consideration of all the evidence, you are convinced beyond a reasonable doubt that the defendant is guilty, it is your duty to find the defendant guilty.

What Is Evidence

The evidence you are to consider in deciding what the facts are consists of:

- (1) the sworn testimony of any witness;
- (2) the exhibits received in evidence; and
- (3) any facts to which the parties have agreed.

What Is Not Evidence

In reaching your verdict you may consider only the testimony and exhibits received in evidence. The following things are not evidence and you may not consider them in deciding what the facts are:

1. Questions, statements, objections, and arguments by the lawyers are not evidence. The lawyers are not witnesses. Although you must consider a lawyer's questions to understand the answers of a witness, the lawyer's questions are not evidence. Similarly, what the lawyers have said in their opening statements, [will say in their] closing arguments and at other times is intended to help you interpret the evidence, but it is not evidence. If the facts as you remember them differ from the way the lawyers state them, your memory of them controls.
2. Any testimony that I have excluded, stricken, or instructed you to disregard is not evidence. [In addition, some evidence was received only for a limited purpose; when I have instructed you to consider certain evidence in a limited way, you must do so.]
3. Anything you may have seen or heard when the court was not in session is not evidence. You are to decide the case solely on the evidence received at the trial.

Direct and Circumstantial Evidence

Evidence may be direct or circumstantial. Direct evidence is direct proof of a fact, such as testimony by

App. 65

a witness about what that witness personally saw or heard or did. Circumstantial evidence is indirect evidence, that is, it is proof of one or more facts from which you can find another fact.

You are to consider both direct and circumstantial evidence. Either can be used to prove any fact. The law makes no distinction between the weight to be given to either direct or circumstantial evidence. It is for you to decide how much weight to give to any evidence.

Credibility of Witnesses

In deciding the facts in this case, you may have to decide which testimony to believe and which testimony not to believe. You may believe everything a witness says, or part of it, or none of it.

In considering the testimony of any witness, you may take into account:

- (1) the witness's opportunity and ability to see or hear or know the things testified to;
- (2) the witness's memory;
- (3) the witness's manner while testifying;
- (4) the witness's interest in the outcome of the case, if any;
- (5) the witness's bias or prejudice, if any;
- (6) whether other evidence contradicted the witness's testimony;

App. 66

- (7) the reasonableness of the witness's testimony in light of all the evidence; and
- (8) any other factors that bear on believability.

The weight of the evidence as to a fact does not necessarily depend on the number of witnesses who testify. What is important is how believable the witnesses were, and how much weight you think their testimony deserves.

Activities Not Charged

You are here only to determine whether the defendants are guilty or not guilty of the charges in the indictment. The defendants are not on trial for any conduct or offense not charged in the indictment.

Separate Consideration of Multiple Counts—Multiple Defendants

A separate crime is charged against one or more of the defendants in each count. The charges have been joined for trial. You must decide the case of each defendant on each crime charged against that defendant separately. Your verdict on any count as to any defendant should not control your verdict on any other count or as to any other defendant.

All the instructions apply to each defendant and to each count unless a specific instruction states that it applies only to a specific defendant or count.

Statements by Defendant

You have heard testimony that the defendant made a statement. It is for you to decide (1) whether the defendant made the statement, and (2) if so, how much weight to give to it. In making those decisions, you should consider all the evidence about the statement, including the circumstances under which the defendant may have made it.

Other Crimes, Wrongs, or Acts of Defendant

You have heard evidence that the defendant committed other crimes, wrongs, or acts not charged here. You may consider this evidence only for its bearing, if any, on the question of the defendant's intent, motive, preparation, plan, knowledge, or absence of mistake, and for no other purpose. You may not consider this evidence as evidence of guilt of the crime for which the defendant is now on trial.

Opinion Evidence, Expert Witnesses

You have heard testimony from IRS Revenue Agent Ryan Weitzel who testified to opinions and the reasons for his opinion. This opinion testimony is allowed because of the education or experience of this witness.

Such opinion testimony should be judged like any other testimony. You may accept it or reject it, and give it as much weight as you think it deserves, considering the witness's education and experience, the reasons

given for the opinion, and all the other evidence in the case.

Charts and Summaries in Evidence

Certain charts and summaries have been admitted in evidence. Charts and summaries are only as good as the underlying supporting material. You should, therefore, give them only such weight as you think the underlying material deserves.

Criminal Case

This is a criminal case, not a civil case. The government must prove the elements of the criminal offenses brought beyond a reasonable doubt. There is no allegation that the Internal Revenue Service made any civil collection efforts, including any audit, or that the defendants interfered with such efforts.

Elements of Conspiracy to Defraud the United States

Both of the defendants are charged in Count One of the indictment with conspiring to defraud the United States by obstructing the lawful functions of the Internal Revenue Service by deceitful or dishonest means in violation of Section 371 of Title 18 of the United States Code. In order for the defendants to be found guilty of that charge, the government must prove each of the following elements beyond a reasonable doubt:

App. 69

First, beginning on or about September 15, 2009, and ending on or about March 1, 2011, there was an agreement between two or more persons to defraud the United States by obstructing the lawful functions of the Internal Revenue Service by deceitful or dishonest means as charged in the indictment;

Second, the defendant became a member of the conspiracy knowing of at least one of its objects and intending to help accomplish it; and

Third, one of the members of the conspiracy performed at least one overt act on or after September 15, 2009, for the purpose of carrying out the conspiracy, with all of you agreeing on a particular overt act that you find was committed.

An agreement to defraud is an agreement to deceive or to cheat.

A conspiracy is a kind of criminal partnership—an agreement of two or more persons to commit one or more crimes. The crime of conspiracy is the agreement to do something unlawful; it does not matter whether the crime agreed upon was committed.

For a conspiracy to have existed, it is not necessary that the conspirators made a formal agreement or that they agreed on every detail of the conspiracy. It is not enough, however, that they simply met, discussed matters of common interest, acted in similar ways, or perhaps helped one another. You must find that there was a plan to commit at least one of the crimes alleged in the indictment as an object of the conspiracy with all

App. 70

of you agreeing as to the particular crime which the conspirators agreed to commit.

One becomes a member of a conspiracy by willfully participating in the unlawful plan with the intent to advance or further some object or purpose of the conspiracy, even though the person does not have full knowledge of all the details of the conspiracy. Furthermore, one who willfully joins an existing conspiracy is as responsible for it as the originators. On the other hand, one who has no knowledge of a conspiracy, but happens to act in a way which furthers some object or purpose of the conspiracy, does not thereby become a conspirator. Similarly, a person does not become a conspirator merely by associating with one or more persons who are conspirators, nor merely by knowing that a conspiracy exists.

An overt act does not itself have to be unlawful. A lawful act may be an element of a conspiracy if it was done for the purpose of carrying out the conspiracy. The government is not required to prove that the defendant personally did one of the overt acts.

Filing a False Tax Return—Elements

Defendant Tracy Chang is charged in Count Two of the indictment with filing a false tax return in violation of Section 7206(1) of Title 26 of the United States Code.

App. 71

In order for the defendant to be found guilty of Count Two, the government must prove each of the following elements beyond a reasonable doubt:

First, Defendant Chang signed and filed a U.S. Corporation Income Tax Return (Form 1120) for Did-see Corporation for the year 2008 that she knew contained false information as to a material matter;

Second, the return contained a written declaration that it was being signed subject to the penalties of perjury; and

Third, in filing the false tax return, Defendant Chang acted willfully.

A matter is material if it had a natural tendency to influence, or was capable of influencing, the decisions or activities of the Internal Revenue Service.

Aiding or Advising a False Income Tax Return

Defendant Howard Hsu is charged in Counts Four, Five and Six of the indictment with aiding and assisting the preparation of a false income tax return in violation of Section 7206(2) of Title 26 of the United States Code.

In order for the defendant to be found guilty of Count Four, the government must prove each of the following elements beyond a reasonable doubt:

First, the defendant aided, assisted, or otherwise caused the preparation and presentation of a U.S.

App. 72

Corporation Income Tax Return (Form 1120) for Didsee Corporation for 2008 that was false or fraudulent;

Second, the income tax return was false or fraudulent as to any material matter necessary to a determination of whether income tax was owed; and

Third, the defendant acted willfully.

In order for the defendant to be found guilty of Count Five, the government must prove each of the following elements beyond a reasonable doubt:

First, the defendant aided, assisted, or otherwise caused the preparation and presentation of a U.S. Corporation Income Tax Return (Form 1120) for Didsee Corporation for 2009 that was false or fraudulent;

Second, the income tax return was false or fraudulent as to any material matter necessary to a determination of whether income tax was owed; and

Third, the defendant acted willfully.

In order for the defendant to be found guilty of Count Six, the government must prove each of the following elements beyond a reasonable doubt:

First, the defendant aided, assisted, or otherwise caused the preparation and presentation of an Amended U.S. Corporation Income Tax Return (Form 1120X) for Didsee Corporation for 2007 that was false or fraudulent;

App. 73

Second, the income tax return was false or fraudulent as to any material matter necessary to a determination of whether income tax was owed; and

Third, the defendant acted willfully.

A matter is material if it had a natural tendency to influence, or was capable of influencing, the decisions or activities of the Internal Revenue Service.

Willfully—Defined

In order to prove that the defendants acted “willfully,” the government must prove beyond a reasonable doubt that the defendants knew federal tax law imposed a duty on him or her, and the defendants intentionally and voluntarily violated that duty.

Duty to Deliberate

When you begin your deliberations, elect one member of the jury as your [presiding juror] [foreperson] who will preside over the deliberations and speak for you here in court.

You will then discuss the case with your fellow jurors to reach agreement if you can do so. Your verdict, whether guilty or not guilty, must be unanimous.

Each of you must decide the case for yourself, but you should do so only after you have considered all the evidence, discussed it fully with the other jurors, and listened to the views of your fellow jurors.

App. 74

Do not be afraid to change your opinion if the discussion persuades you that you should. But do not come to a decision simply because other jurors think it is right.

It is important that you attempt to reach a unanimous verdict but, of course, only if each of you can do so after having made your own conscientious decision. Do not change an honest belief about the weight and effect of the evidence simply to reach a verdict.

Consideration of Evidence

Because you must base your verdict only on the evidence received in the case and on these instructions, I remind you that you must not be exposed to any other information about the case or to the issues it involves. Except for discussing the case with your fellow jurors during your deliberations:

Do not communicate with anyone in any way and do not let anyone else communicate with you in any way about the merits of the case or anything to do with it. This includes discussing the case in person, in writing, by phone or electronic means, via email, text messaging, or any Internet chat room, blog, website or other feature. This applies to communicating with your family members, your employer, the media or press, and the people involved in the trial. If you are asked or approached in any way about your jury service or anything about this case, you must respond

App. 75

that you have been ordered not to discuss the matter and to report the contact to the court.

Do not read, watch, or listen to any news or media accounts or commentary about the case or anything to do with it; do not do any research, such as consulting dictionaries, searching the Internet or using other reference materials; and do not make any investigation or in any other way try to learn about the case on your own.

The law requires these restrictions to ensure the parties have a fair trial based on the same evidence that each party has had an opportunity to address. A juror who violates these restrictions jeopardizes the fairness of these proceedings, and a mistrial could result that would require the entire trial process to start over. If any juror is exposed to any outside information, please notify the court immediately.

Use of Notes

Some of you have taken notes during the trial. Whether or not you took notes, you should rely on your own memory of what was said. Notes are only to assist your memory. You should not be overly influenced by your notes or those of your fellow jurors.

Jury Consideration of Punishment

The punishment provided by law for this crime is for the court to decide. You may not consider punishment in deciding whether the government has proved

App. 76

its case against the defendant beyond a reasonable doubt.

Verdict Form

A verdict form has been prepared for you. After you have reached unanimous agreement on a verdict, your presiding juror should complete the verdict form according to your deliberations, sign and date it, and advise the clerk that you are ready to return to the courtroom.

Communication with Court

If it becomes necessary during your deliberations to communicate with me, you may send a note through the clerk, signed by any one or more of you. No member of the jury should ever attempt to communicate with me except by a signed writing, and I will respond to the jury concerning the case only in writing or here in open court. If you send out a question, I will consult with the lawyers before answering it, which may take some time. You may continue your deliberations while waiting for the answer to any question. Remember that you are not to tell anyone—including me—how the jury stands, numerically or otherwise, on any question submitted to you, including the question of the guilt of the defendant, until after you have reached a unanimous verdict or have been discharged.

AO 93 (Rev. 01/09) Search and Seizure Warrant

UNITED STATES DISTRICT COURT
for the
Northern District of California

In the Matter of the Search of)
(Briefly describe the property to)
be searched or identify the) Case No. 3 11 70288
person by name and address)) JCS
3435 Clement St.)
San Francisco, CA)

SEARCH AND SEIZURE WARRANT

(Filed Apr. 1, 2011)

To: Any authorized law enforcement officer

An application by a federal law enforcement officer or an attorney for the government requests the search of the following person or property located in the Northern District of California (*identify the person or describe the property to be searched and give its location*):

3435 Clement St., San Francisco, CA – See Attachment A which is incorporated by reference.

The person or property to be searched, described above, is believed to conceal (*identify the person or describe the property to be seized*):

App. 78

See Attachment B which is incorporated by reference.

I find that the affidavit(s), or any recorded testimony, establish probable cause to search and seize the person or property.

YOU ARE COMMANDED to execute this warrant on or before 3/28/11
(*not to exceed 10 days*)

- in the daytime 6:00 a.m. to 10 p.m.
- at any time in the day or night as I find reasonable cause has been established.

Unless delayed notice is authorized below, you must give a copy of the warrant and a receipt for the property taken to the person from whom, or from whose premises, the property was taken, or leave the copy and receipt at the place where the property was taken.

The officer executing this warrant, or an officer present during the execution of the warrant, must prepare an inventory as required by law and promptly return this warrant and inventory to United States Magistrate Judge Joseph C. Spero

(*name*)

I find that immediate notification may have an adverse result listed in 18 U.S.C. § 2705 (except for delay of trial), and authorize the officer executing this warrant to delay notice to the person who, or whose

App. 79

property, will be searched or seized (*check the appropriate box*) for ____ days (*not to exceed 30*).

until, the facts justifying, the later specific date of ____

Date and time issued: /s/ Joseph Spero
3/18/11 3:30 pm Judge's signature

City and state: San Francisco, California

Honorable Joseph C. Spero.
United States Magistrate Judge
Printed name and title

Return		
Case No. 3 11 70288 JCS	Date and time warrant executed: 3/22/2011 7:02 AM	Copy of warrant and inventory left with: John Hsu
Inventory made in the presence of: Special Agent Adam Gray		
Inventory of the property taken and name of any person(s) seized:		
See Attachment		
Certification		
I declare under penalty of perjury that this inventory is correct and was returned along with the original warrant to the designated judge.		

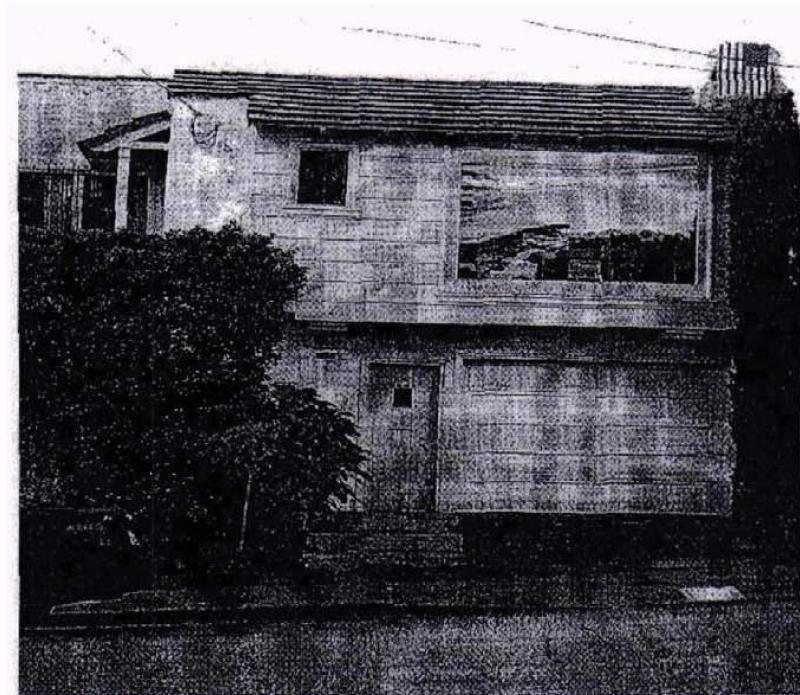
Date: <u>04/01/2011</u>	/s/ <u>Justin Fletcher</u> <i>Executing officer's signature</i> <u>Justin Fletcher Special Agent</u> <i>Printed name and title</i>
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ATTACHMENT A

DESCRIPTION OF PROPERTIES
TO BE SEARCHED

This affidavit is made in support of an application for a warrant to search the following property owned or controlled by TRACY CHANG (hereafter referred as CHANG):

1. The residence of CHANG, located at 3435 Clement St., San Francisco, California and any attached or detached outbuildings. It is described as a two-storied, single family residence with a cream colored facade. There are two entries into the house from the front, the ground floor front door and the garage door. (See Picture below)



DESCRIPTION OF ITEMS TO BE SEIZED

The property sought to be seized is limited to the records, documents, and items described below including the time period December 2006 until January 2010 belonging to pertaining to, or referring to any of the following persons, entities, or addresses (including any variation in spelling or initials of the individuals and entities listed below):

- a. Tracy Chang
- b. John Hsu
- c. Howard Hsu
- d. Lydia Vanmonyra Krin
- e. Chun-Der Chang
- f. Ching Shih Chang

App. 82

- g. Didsee Corporation
- h. 3435 Clement St. San Francisco, California
- i. P.O. Box 591472, San Francisco, California
- j. 5348 Vegas Dr., Las Vegas, Nevada

The following records, documents, files, or materials, in whatever form, including handmade or mechanical form (such as printed, written, handwritten, or types [sic]); photocopies of other photographic form including faxes; and electrical, electronic, and magnetic form (such as tapes, cassettes, hard disks, floppy disks, diskettes, compact discs, CD-ROMs, DVDs, optical discs, Zip cartridges, printer buffers, smart cards, portable flash memory sticks, or electronic notebooks, or any other storage medium), except that seizure of any evidence stored in digital form shall be governed also by Attachment C.

1. Bookkeeping records and other financial records including income statements, balance sheets, general ledgers, general journals, gross receipts records, sales records, income records, cash receipts records, cash receipts schedules, disbursement records and/or journals, sales and purchase records and/or journals, accounts receivable and accounts payable records, cost of goods sold records, loan receivable and loan payable ledgers, daily sales schedules, evidence of travel expense, and all sales and expense invoices including all invoices documenting expenses paid by cash (currency) or bank check (cashier or teller checks) and retained copies of any bank checks, (cashier or teller check).

App. 83

2. Financial statements, bookkeeper's, Certified Public Accountant's and accountant's work-papers used in preparation of loan applications, financial statements, and income tax returns. Copies of tax returns and related tax preparation files.
3. Documents that can be used to establish gross sales including customer receipts, customer invoices, escrow closing statements, and any other source documentation.
4. Calendar book, daily planner, and personal organizers recording business contacts, associates, and information.
5. Employee personnel records, including lists of employees and employee information such as Social Security Number, address, telephone number, electronic mail (e-mail) address, or other identifying information. Any schedules or other records of payment made to employees by check or cash (currency).
6. Documentation showing the names, addresses, and or telephone numbers for customers.
7. Bank account records including passbooks, bank statements, records reflecting dates and amounts of deposits, withdrawals, interest, debit and credit memos, deposit slips, records reflecting the identity of checks deposited, withdrawal slips, and records disclosing the disposition of withdrawals, Form 1099s issued or received, carbon copies of monetary instruments, debit memos, and credit memos.

App. 84

Records of any certificates of deposit, money market certificates, U.S. Treasury Notes or Bills purchased.

8. Documents reflecting personal living expenditures comprising evidence of expenditures. Documents may include receipts from stores, gambling establishments, casino player cards, travel itineraries, or jewelry stores.
9. Loan records: Including applications, financial statements, credit card statements, loan collateral, credit and background investigations required, loan agreements, notes or mortgages, settlement sheets, contracts, retained copies of checks issued for loans, repayment records, including records revealing the date, amount, and method of repayment (cash, check, or money order), checks used to repay loans and a record disclosing the total amount of discount or interest paid annually, records of any liens, loans correspondence files, and internal memoranda relative to these loans.
10. Correspondence and notes, in both electronic (e-mail) and physical form, with customers, employees, suppliers.
11. Correspondence and notes, in both electronic (e-mail) and physical form related to income, income tax, or the assertion that anyone is exempt from Internal Revenue Laws, Documents, newspaper articles, copies of court cases, copies of court decisions relating to income and income tax.

App. 85

12. Lease agreements: Including applications, financial statements, collateral, credit and background investigations required, contracts, and payments records including records revealing the date, amount and method of payment (cash or check).
13. Items showing indicia of ownership of any individual or entity (listed in a-j above) and/or any real property.
14. Bankruptcy records: including filings for bankruptcy, documents related to filings for bankruptcy, and disposition of any bankruptcy filings.
15. Any safes found on the premises where any of the items listed in this Attachment might be found as well as any safety deposit box keys, information regarding the location of safety deposit boxes, storage locker keys and information regarding the location of any storage lockers.
16. Any passwords, password files, test keys, encryption codes or other information necessary to access the computer equipment, storage devices or data, as limited by Attachment C.
17. As limited by Attachment C, all electronic devices which are capable of analyzing, creating, displaying, converting, or transmitting electronic or magnetic computer impulses or data. These devices include, but are not limited to, computers, computer components, computer peripherals, removable media (floppy disks, Zip disks, tapes, CD-ROM's, DVDs, smart

App. 86

cards, flash cards), word processing equipment, modems, monitors, plotters, encryption circuit boards, optical scanners, external hard disk drives, and other computer related electronic devices.

18. As limited by Attachment C, all instruction or programs stored in the form of electronic or magnetic media which are capable of being interpreted by a computer or related components. The items to be seized include, but are not limited to, operating systems, application software, passwords, decryption keys, utility programs, compilers, interpreters, and any other programs or software used to communicate with computer hardware or peripherals either directly or indirectly via telephone lines, radio, or other means of transmission.
19. All written or printed material which provides instructions or examples concerning the operation of a computer system, computer software, and/or any related device which is present at the scene.
20. As limited by Attachment C, all stated electronic data that might help identify who was using a computer at a particular time, such as records of Internet activity (use of and log ins to email, financial, or other web sites) and other user-inputted data.

ATTACHMENT C

United States District Court for the
Northern District of California

PROTOCOL FOR SEARCHING DEVICES OR MEDIA THAT STORE DATA ELECTRONICALLY

THIS PROTOCOL WILL BE ATTACHED TO EACH
SEARCH WARRANT THAT AUTHORIZES A
SEARCH OF ANY DEVICE OR MEDIA THAT
STORES DATA ELECTRONICALLY

1. In executing this warrant, the government will begin by ascertaining whether all or part of a search of a device or media that stores data electronically ("the device") reasonably can be completed at the location listed in the warrant ("the site") within a reasonable time. If the search reasonably can be completed on site, the government will remove the device from the site only if removal is necessary to preserve evidence, or if the item is contraband, a forfeitable instrumentality of the crime, or the fruit of a crime.
2. If the government determines that a search reasonably cannot be completed on site within a reasonable time period, the government must determine whether all or part of the authorized search can be completed by making a mirror image of, or in some other manner duplicating, the contents of the device and then conducting the forensic review of the mirror image or duplication off site. The government will complete a Forensic review of that mirror

App. 88

image within 120 days of the execution of the search warrant.

3. In a circumstance where the government determines that a mirror image of the contents of a device cannot be created on site in a reasonable time, the government may seize and retain that device for 60 days in order to make a mirror image of the contents of the device.
4. When the government removes a device from the searched premises it may also remove any equipment or documents (“related equipment or documents”) that reasonably appear to be necessary to create a mirror image of the contents of the device or conduct an off-site forensic review of a device.
5. When the government removes a device or related equipment or documents from the site in order to create a mirror image of the device’s contents or to conduct an off-site forensic review of the device, the government must file a return with a magistrate judge that identifies with particularity the removed device or related equipment or documents within 14 calendar days of the execution of the search warrant.
6. Within a reasonable period of time, but not to exceed 60 calendar days after completing the forensic review of the device or image, the government must use reasonable efforts to return, delete, or destroy any data outside the scope of the warrant unless the government is otherwise permitted by law to retain such data.

7. The time periods set forth in this protocol may be extended by court order for good cause.
8. In the forensic review of any device or image under this warrant the government must make reasonable efforts to use methods and procedures that will locate and expose those categories of files, documents, or other electronically-stored information that are identified with particularity in the warrant, while minimizing exposure or examination of irrelevant, privileged, or confidential files, to the extent reasonably practicable.
9. For the purposes of this search protocol, the phrase "to preserve evidence" is meant to encompass reasonable measures to ensure the integrity of information responsive to the warrant and the methods used to locate same.

Inventory Listing of All Items Seized at Search Warrant Site

Site Name:	Investigation Number:	Report Date:
3435 Clement Street San Francisco, CA	1000239795	Tuesday, March 22, 2011
Residence	Starting Date and Time:	
	03/22/2011 07:02 AM	
	Ending Date and Time:	
	03/22/2011 11:20 AM	

Control #:	1	Evidence Box: 1
Location:	Master Bedroom	Locator Code: D
Found:	In Tote on Floor	
Description:	Seized Per Warrant Daily Planner book; black leather cover	
Control #:	2	Evidence Box: 1
Location:	Living Room	Locator Code: A
Found:	Filing Cabinet	
Description:	Seized Per Warrant Social Security Statement, Howard Hsu Drivers License copy, news articles, business proposal	
Control #:	3	Evidence Box: 1
Location:	Living Room	Locator Code: A
Found:	Cabinet beside the dining room table	
Description:	Seized Per Warrant Bank statement and bills	
Control #:	4	Evidence Box:
Location:	Living Room	Locator Code: A
Found:	On Chair	
Description:	Seized Per Warrant Tax forms for Didsee Corp; 2009 tax return for John Hsu and Tracy Chang; and communications between Howard Hsu and Tracy Chang	
Control #:	5	Evidence Box: 1
Location:	Living Room	Locator Code: A
Found:	In a Box on the Floor	
Description:	Seized Per Warrant 2007 and 2008 federal and state tax return, Affinity Bank statements, Chase bank statements, Citibank statements, Wells Fargo bank statements, American Express statements, receipts	

Control #:	6	Evidence Box: 1
Location:	Living Room	Locator Code: A
Found:	Plastic Ben [sic] on Chair	
Description:	Seized Per Warrant Didsee Corp Investments, Bank records	
Control #:	7	Evidence Box: 2
Location:	Living Room	Locator Code: A
Found:	Plastic Ben [sic] on Chair	
Description:	Seized Per Warrant Didsee Corp investments	
Control #:	8	Evidence Box: 2
Location:	Up Level Bed/Office	Locator Code: E
Found:	Inside box next to bed	
Description:	Seized Per Warrant PG&E, personal expenditures Howard Hsu	
Control #:	9	Evidence Box: 3
Location:	Master Bedroom	Locator Code: D
Found:	On the Floor at the foot of bed	
Description:	Seized Per Warrant Image of Acer Aspire Laptop; Hitachi QCE11J6G	
Control #:	10	Evidence Box: 2
Location:	Living Room	Locator Code: A
Found:	Plastic Container	
Description:	Seized Per Warrant Multiple Bank accounts 2007 to 2010; accounts in the name of various individuals and Didsee Corporation (2 bags)	
Control #:	11	Evidence Box: 1
Location:	Upper Level	Locator Code: C
Found:	Bathroom	
Description:	In the bathtub	
Description:	Seized Per Warrant Document written in Chinese re: tax matters	

App. 92

Control #:	12	Evidence Box:	3
Location:	Living Room	Locator Code:	A
Found:	Desk		
Description:	Seized Per Warrant Image of HP Pavilion Serial: CNF5371WFV Hard drive SeaGate Model S79402113A Serial 3LE0TL6A		

**U.S. DISTRICT COURT NORTHERN
DISTRICT OF CALIFORNIA**

Trial Exhibit 716

CASE NO. 15-cr-00067-WHO

DATE ENTERED:

BY:

from: Dominique Molina, CPA <dominique@usa-taxcoach.com>
to: Howard Hsu <misterhowardhsu@gmail.com>
cc: Howard Hsu <mrhowardhsu@gmail.com>
date: Mon, Sep 15, 2008 at 10:26 AM
subject: 2007 Draft Didsee Corp

Hello Howard

Attached please find your 2007 draft of Didsee Corp tax return. Please take a moment to review.

One item of note: Your Balance Sheet was still out of balance by the \$3,500 capital stock purchase. This is for one of two reasons, either the \$3,500 deposit is not figured into your ending cash balance, or, the \$3,500 stock purchase was made by the shareholders paying expenses on the corporations behalf (in which case there are unrecorded expenses). We have recorded a receivable on the books to represent this which you will notice on Schedule L page 4 of the return. Your options are to leave this as-is, adjust your cash (increase) or add an expense (decrease net income). Please let me know what you prefer to do.

You will also find your final invoice please confirm that I can charge your credit card on file.

App. 94

As you know, today is the deadline, so please reply with your request as soon as possible.

Best Regards,

Dominique Molina, CPA
Managing Partner
www.AccountOnItCPA.com
(619) 297-4811 ext. 706
(619) 297-4817 fax

from: Howard Hsu <misterhowardhsu@gmail.com>
to: "Dominique Molina, CPA" <dominique@usa-taxcoach.com>
date: Mon, Sep 15, 2008 at 11:49 AM
subject: Re: 2007 Draft Didsee Corp

Sorry, the \$3500 was not added to the cash balance. Let's just add \$3500 to cash (on the balance sheet). I'd prefer not to record it as a receivable. Thanks.

And yes, please feel free to charge the card on file for the balance.

What are next steps? Do you need a signature from Tracy Chang? The signature line says "Manager." Should it be "President?"

// howard hsu
// aim | misterhowardhsu
// cell | 415.672.8088

App. 95

from: Dominique Molina, CPA <dominique@usataxcoach.com>
to: Howard Hsu <misterhowardhsu@gmail.com>
date: Mon, Sep 15, 2008 at 12:03 PM
subject: RE: 2007 Draft Didsee Corp

Thanks for the quick reply. I made the changes to cash. Please see revised draft. I also indicated signer as "president."

Yes I do need Tracy to sign the attached efile authorization form and return via fax or email today, and please mail the original. As soon as I receive the signed authorization, I'll transmit the return electronically to the IRS.

Your original copies will go out in tomorrow's mail along with your W-2 information.

Looking forward, I do see some missed opportunities and a lot of ideas for tax strategies. I recommend considering a ProActive Tax Strategy to reduce your 2008 taxes. Just let me know if you'd like some more information on this.

Best Regards,

Dominique

App. 96

from: Dominique Molina, CPA <dominique@usataxcoach.com>
to: Howard Hsu <misterhowardhsu@gmail.com>
cc: Howard Hsu <mrhowardhsu@gmail.com>
date: Mon, Sep 15, 2008 at 12:04 PM
subject: FW: 2007 Draft Didsee Corp

[BLANK EMAIL BODY]

2 attachments

Efile Authorization.pdf 131K
Draft 2007 Tax Return.pdf 247K

from: Howard Hsu <misterhowardhsu@gmail.com>
to: "Dominique Molina, CPA" <dominique@usa-taxcoach.com>
date: Mon, Sep 15, 2008 at 3:52 PM
subject: Re: FW: 2007 Draft Didsee Corp

Please find attached the signed efile authorization form. Where would you like me to send the original?

For the W-2 and copy of the final 2007 Didsee return, please mail it to:

Howard Hsu
PO Box 591472
San Francisco, CA 94159

As for proactive strategies, please let me know what you had in mind. I remember starting this discussion earlier this year, but never followed up on it. If we

App. 97

proceed on this topic, I would very much like to schedule an in-person meeting. It works better for me.

Thanks.

from: Dominique Molina, CPA <dominique@usatxcoach.com>
to: Howard Hsu <misterhowardhsu@gmail.com>
date: Tue, Sep 16, 2008 at 10:09 AM
subject: RE: FW: 2007 Draft Didsee Corp

Hi Howard

Please mail the original to:

AccountOnIt, LLP
7710 Hazard Center Dr Ste E-405
San Diego, CA 92108

Your originals will be mailed today to your address below. The corporate return was filed electronically and accepted by the IRS on September 15, 2008.

I've attached some information for you on the ProActive Tax Strategies. It is a step-by-step action plan to positioning yourself and using tax loopholes so you can legally lower your tax.

It is definitely possible to meet in person if you prefer. I will be in San Francisco on October 9-13 and again in November. And you are always welcome here if you are in San Diego.

What I would recommend is complete the attached questionnaire and return it to me. I can give you a free

App. 98

estimate of your tax savings from using a strategy, and then you can decide if you want to make the investment. Most clients in your similar position save on average \$20,000-\$150,000 per year in tax by implementing one of my tax strategies.

The only question left is when do you want to start paying less tax? The sooner you send me your information, the sooner you can start paying less tax!

Best Regards,

Dominique Molina

from: Howard Hsu <misterhowardhsu@gmail.com>
to: "Dominique Molina, CPA" <dominique@usa-taxcoach.com>
date: Tue, Sep 16, 2008 at 2:00 PM
subject: Re: FW: 2007 Draft Didsee Corp

Thanks. I'll get the original out today.

The last time you sent me a tax questionnaire, it was level II (\$2500). Now, you're sending me level III (\$3500). What are the differences between levels 1, 2 and 3? If I'm not interested in moving personal expenses (which are minimal) over to my business and not open to an employer-sponsored retirement plan, do you still foresee much in tax savings? What are the topics covered in each strategy? Is there a guarantee of sorts?

I am able to meet in SF or SD. I guess the timing will determine which makes more sense.

App. 99

from: Dominique Molina, CPA <dominique@usatxcoach.com>
to: Howard Hsu <misterhowardhsu@gmail.com>
date: Tue, Sep 23, 2008 at 7:31 PM
subject: RE: FW: 2007 Draft Didsee Corp

Hi Howard

The differences between a Level II and Level III strategy have to do with your business holdings. At your current income level, I would highly recommend a Level III strategy. In this, I will be looking at multiple business entities to take advantage of income shifting concepts and more complex loopholes. A Level II strategy is for business owners with fairly straightforward businesses who are still working in the business day-to-day and not yet into passive income territory. Here is what we do with the strategy:

Save with pre-tax money

- Invest with pre-tax money
- Find income tax loopholes to increase your income
- Plan for alternative minimum tax (AMT) as your income grows
- Identify and get rid of non or under-performing investments
- Plan for U.S. dollar devaluation

App. 100

- Identify upcoming tax law changes and adjust your Pre-Emptive Tax Strategy accordingly
- Understand where you have no investment control – and how to shift investment strategies to things you CAN control
- Protect your growing wealth and asset base with proper business structures and other assetprotection measures.

Yes it is possible to save more in tax without the things you mentioned below, but it really depends on your goals. That is why I request the questionnaire. Once you complete it, I can do an estimate for you before you commit to proceeding with the full strategy.

I cannot legally guarantee a savings, but that is why I offer the free estimate so you have an idea before you invest.

Dominique

from: Howard Hsu <misterhowardhsu@gmail.com>
to: "Dominique Molina, CPA" <dominique@usa-taxcoach.com>
date: Tue, Oct 7, 2008 at 2:15 PM
subject: Re: FW: 2007 Draft Didsee Corp

Hi Dominique,

I got your message. Please put me down for 11AM, Friday, October 17th. Do you want to do an early lunch?

App. 101

I'll have the questionnaire back to you early next week before we meet.

Looking forward to meeting you,

from: Dominique Molina, CPA <dominique@usataxcoach.com>
to: Howard Hsu <misterhowardhsu@gmail.com>
date: Thu, Oct 9, 2008 at 1:22 PM
subject: RE: FW: 2007 Draft Didsee Corp

Hello Howard

Sounds perfect, see you then!

Dominique

from: Howard Hsu <misterhowardhsu@gmail.com>
to: "Dominique Molina, CPA" <dominique@usa-taxcoach.com>
date: Thu, Oct 9, 2008 at 1:24 PM
subject: Re: FW: 2007 Draft Didsee Corp

Which office location will you be at?

App. 102

from: Dominique Molina, CPA <dominique@usatxcoach.com>
to: Howard Hsu <misterhowardhsu@gmail.com>
date: Thu, Oct 9, 2008 at 1:38 PM
subject: RE: FW: 2007 Draft Didsee Corp

At our mission valley office at 7676 Hazard Center Drive, 5th Floor San Diego, CA 92108. Very central near the 8, 163, 805 and 15 freeways.

See you then!

from: Howard Hsu <misterhowardhsu@gmail.com>
to: "Dominique Molina, CPA" <dominique@usa-taxcoach.com>
date: Wed, Oct 15, 2008 at 1:49 PM
subject: Re: FW: 2007 Draft Didsee Corp

Hi Dominique,

I've attached the completed tax questionnaire. Please keep in mind that this tax strategy should be more focused around Didsee Corporation as that is where the majority of my wealth is made/stored.

I look forward to meeting you on Friday. I arrive in San Diego at 10:10am and plan to be at your office at 11:00am. If you have any questions before then, do feel free to send them my way.

Thanks,
Howard Hsu.

from: Dominique Molina, CPA <dominique@usatxcoach.com>
to: Howard Hsu <misterhowardhsu@gmail.com>
date: Wed, Oct 15, 2008 at 6:01 PM
subject: RE: FW: 2007 Draft Didsee Corp

Hi Howard

Unfortunately, I've had a medical emergency come up and I may not be available to meet with you Friday. I am scheduled for surgery tomorrow morning at 11. The doctor says I should be back at work on Friday, but I am not sure how I will be feeling. Please know I will try my best to be at our meeting but I may need to reschedule with you.

If you would prefer to reschedule rather than have a late cancellation, just let me know. Otherwise, please let me know a good number to reach you at on Friday morning and I can have my assistant call you if I am unable to make it.

Thanks for your patience. Know that it really does take something serious to cause this sort of delay and I will make every effort to keep our appointment.

Thanks,
Dominique

from: Howard Hsu <misterhowardhsu@gmail.com>
to: "Dominique Molina, CPA" <dominique@usa-taxcoach.com>
date: Thu, Oct 16, 2008 at 8:56 AM
subject: Re: FW: 2007 Draft Didsee Corp

Hi Dominique,

I hope everything goes smoothly and you have a speedy recovery. My plans to come into San Diego are pretty set, but if you have to cancel it's not that big of a deal. Your health definitely is. Please have your assistant call me on my cell phone at 415.672.8088, so I know whether or not to come by your office tomorrow.

Take care,

Howard Hsu.

**U.S. DISTRICT COURT NORTHERN
DISTRICT OF CALIFORNIA**

Trial Exhibit 740

CASE NO. 15-cr-00067-WHO

DATE ENTERED:

BY:

accountonit, llp
CERTIFIED PUBLIC
ACCOUNTANTS

7710 Hazard Center Drive,
Suite E-405
San Diego, California 92108
www.accountonitcpa.com

November 6, 2008

CONFIDENTIAL

Mr. Howard Hsu
PO Box 591472
San Francisco, CA 94159

Dear Howard:

Enclosed please find a copy of your personalized tax strategy. This report was prepared based on our strategy session today. I have summarized below the highlights of the strategy as well as an action item list for you to begin implementing your plan right away!

Your personalized tax strategy consists of a plan to use 3 different entities to hold your business interests. The purpose of using multiple entities is to reduce risk and protect your assets, lower your tax liability by taking advantage of favorable tax loopholes available through structuring, and succession planning. Here is a brief description of the 3 entities I recommend:

App. 106

1. Software Holding Company, Inc. – an S corporation, 100% ownership interest by your mother. I recommend holding your software intellectual property in this entity. Use of the S corporation election will allow you to avoid self-employment tax, and help you to avoid C corporation tax issues such as Personal Holding Company and Accumulated Earnings Issues. , I recommend setting a reasonable salary for yourself as an officer of the corporation and withdraw the remainder of your profits through distributions. Use of this strategy will save you approximately \$240,000 per year in accumulated earnings and personal holding company taxes, and approximately \$400,000 in the double taxation tax consequences of paying corporate tax in addition to individual tax. See page 8 of your plan report for more information on this strategy.
2. Didsee Corporation – a C corporation, 99% ownership interest by your Nextuni, LLC. I recommend using this corporation to act as your internet marketing company and contract with your S corporation to provide for use of your software. Use of this C corporation in conjunction with your S corporation will allow you to take advantage of the lowest C corporation tax rate (15% on the first \$50,000 of net income), as well as allow you to deduct fringe benefits such as medical insurance, disability insurance, long-term care insurance, life insurance and other de-minimus fringe benefits. Your C corporation will charge your S corporation royalties for software use. Use of this strategy will save you approximately

\$200,000 per year. See page 9 of your plan report for more information on this strategy.

Be cautious in your use of this shifting of income! The Accumulated Earnings tax rules indicate that a maximum of \$250,000 of accumulated earnings can remain in a corporation before additional tax is due. This equates to 5 years of net income totaling \$50,000 per year.

I also recommend that you consider using net profits from the C corporation to invest in a Limited Partnership formed to invest in real estate or other types of investments. This strategy will allow you to use net profits from the corporation without incurring a tax on dividend distributions.

In addition, we spoke of your exit strategy for this business and the use of IRS Code Sections 1202 and 1244. I recommend setting up your C corporation as a Section 1202 and 1244 qualified company. Section 1202 allows you to exclude up to 50 percent of income from the gain or exchange of qualified small business stock that has been held for more than 5 years. The excluded [sic] gain is limited to the greater of \$10 million or 10 times your basis in the stock. Businesses related to health, law, engineering, architecture, farming, insurance, financing, and hospitality are specifically excluded from this loophole.

If your plan does not succeed, you will be able to deduct a valuable loss against your current income through the use of Section 1244. Your corporate documents should include a statement that the company is

App. 108

intended to be a Section 1202 and 1244 company. In addition, to qualify, your company must have less than \$1 million in capital contributions.

I recommend that you consider implementing a defined benefit plan in your C corporation. You may be eligible to contribute up to \$150,000 per year in a defined benefit plan as a business expense. See page 18 of your plan report for more information on defined benefit plans. Use of this strategy will save you approximately \$50,000 per year in tax.

We also discussed the following recommendations to save the most on your annual tax liability.

1. Consider controlling your current income situation to roll-over your current retirement funds into a ROTH IRA. Funds in the ROTH can also be held as self-directed and used to purchase real estate. The biggest benefit of the ROTH is that earnings in the ROTH are not taxable when withdrawn after age 59 1/2. By taking advantage of tax years in which you have no tax and negative taxable income, you can create a strategy to complete these rollovers with little tax effect to you making these funds available to you for your retirement completely tax free. In addition, due to income limitations in the tax law, you may not be eligible in the future to complete this rollover as your income continues to increase.
2. Consider using a Nevis LLC for asset protection and anonymity. Nevis has no requirements to owners, managers, and members.

App. 109

3. Beware of the accumulated earnings tax, which taxes retained earnings in the C corporation. The corporation can accumulate earnings beyond these limits, provided it can prove it has a business need to do so, such as payment of anticipated future operating expenses, a planned business expansion, etc.
4. Consider a medical expense reimbursement plan in your C corporation to deduct out-of-pocket medical expenses as a business expense.
5. Consider purchasing a long-term care plan with a “return of premium” rider. This will allow you to receive a tax deduction for the insurance premium and act as an investment should you not use the long-term care benefits later in life.
6. Consider purchasing your life insurance through your C corporation.
7. Consider a ROTH 401(k) to invest tax free regardless of current income limitations in the standard ROTH account laws. Contributions to the ROTH 401(k) grow tax free and are not taxable when withdrawn at retirement (age 59 1/2).
8. Consider forming a defined benefit plan.

To get you started on putting your plan into action, here is a list of steps to complete. For your convenience we have also included some checklists to assist you.

1. Work with a reliable Attorney to document and protect your Intellectual Property.

App. 110

2. Form an S corporation to hold your intellectual property, with your mother as shareholder to protect your identity.
3. Pay royalty fees from your C corporation to your S corporation.
4. Implement your medical expense reimbursement plan.
5. Consider rolling over your retirement funds to a ROTH IRA.
6. Consider use of a self-directed ROTH IRA to invest your retirement funds in real estate.

You can contact me at any time to schedule your 30 minute follow-up consultation. During this consultation we can discuss questions you may have about your strategy, as well as cover any areas you might like to talk about again. I will also be speaking to you more about our Tax Maintenance Plans and how to better help you achieve your goals!

It has been our pleasure to serve you. I look forward to speaking with you during our follow-up!

Very truly yours,
ACCOUNTONIT, LLP

/s/ Dominique Molina
Dominique Molina, CPA
Enclosure

Tax Strategy

Prepared for:

**Howard Hsu
PO Box 591472
San Francisco, CA 94159**

[LOGO]

CERTIFIED PUBLIC ACCOUNTANTS

Prepared by:

Dominique Molina, CPA
AccountOnIt, LLP
7676 Hazard Center Drive, 5th Floor
San Diego, CA 92108
619-297-4811 x706
dominique@accountonitcpa.com

www.usataxcoach.com

We collect nonpublic personal information about you that we obtain from you or with your authorization.

We don't disclose any nonpublic personal information obtained in the course of our practice except as required or permitted by law. Permitted disclosures include, for instance, providing information to our employees, and in Limited situations, to unrelated third parties who need to know that information to assist us in providing services to you. In all such situations, we stress the confidential nature of information being shared.

We retain records relating to professional services that we provide so that we can better assist you with your professional needs and, in some cases, to comply with professional guidelines. In order to guard your

nonpublic personal information we maintain physical, electronic, and procedural safeguards that comply with our professional standards. Please call us if you have any questions, because your privacy, our professional ethics, and our ability to provide you with quality financial services are very important to us.

Table of Contents

Page Module

Introduction

- 1 How to Use This Plan
- 2 Understand Tax Brackets
- 3 Keep Smart Records To Audit-Proof Your Return
- 4 Understand Audit Odds

Family, Home, & Job

- 5 Own Your Home for Tax and Investment Benefits
- 6 Make the Most of Your Vacation Home

Your Business

- 7 Document “Business Intent” to Preserve Tax Breaks
- 8 Strategies for “S” Corporations
- 9 Strategies for “C” Corporations
- 10 Maximize Car and Truck Deductions
- 11 Buying vs. Leasing Your Vehicle
- 12 Make the Most of Business Meals/Entertainment
- 13 Make the Most of Business Travel
- 14 Separate Entities for Business Assets

- 15 Gift-Leasebacks for Family Tax Savings
- 16 Take Advantage of “Certain Fringe Benefits”
- 17 Consider a Medical Expense Reimbursement Plan
- 18 Consider a Defined Benefit Plan

Cashing Out

- 19 Charitable Trusts for Appreciated Assets

State Taxes

- 20 California

Appendices

- 21 About Your Tax Planner

Introduction: How to Use This Plan

“The avoidance of taxes is the only intellectual pursuit that still carries any reward.”

– John Maynard Keynes

Congratulations! You’ve just taken a giant step towards beating the IRS. This plan gives you a personalized road map for the maximum tax savings allowed by law. But before we start with specific recommendations, let’s review how this plan is organized and how you can use it to squeeze the biggest savings out of your return. You’ll find five main sections:

1. **How the Tax System Works:** This section outlines how the tax system works to lay a foundation for understanding specific strategies to come.

2. **Family, Home, & Job:** This section covers day-to-day strategies for your family, your home, and your job. This section outlines tax strategies for financing college and elder care, buying and owning your home, and making the most of popular employee benefits.
3. **Your Business:** Owning your own business—a bona fide business with a legitimate profit intent—is the best tax shelter left in America. This section outlines strategies for organizing your business, deducting day-to-day expenses, buying and owning real estate and equipment, and choosing retirement and employee benefit plans.
4. **Your Investments:** Making money is hard. *Keeping* it is easier. That's because you have more control over tax-efficiency than any other aspect of your portfolio. This section outlines how to use IRAs and retirement accounts, how to buy and sell stocks, bonds, and mutual funds, and how to manage real estate for maximum after-tax return.
5. **Cashing Out:** This final section outlines strategies to defer or eliminate taxes when you sell personal, business, and investment assets. Just one of these ideas can avoid six- and seven-figure tax bills and help assure your financial legacy for generations.

Supreme Court Justice Oliver Wendell Holmes called taxes “the price we pay for civilization.” But he didn’t say we had to pay retail. This plan is your guide to tax

discounts throughout your return. Enjoy your savings. And don't spend it all in one place!

 ***Filing Guide***

These give you the lowdown on reporting income and deductions where to report them and further IRS resources

 ***Deadlines***

These highlight deadlines for acting to take advantage of strategies

 ***Tax Savers***

These highlight special opportunities to cut your tax. They may be clever ways to use tax laws to your advantages, or bright financial choices that also bring tax relief

 ***Land Mines***

These warn you of potential traps. They may be aggressive positions, IRS red flags, or financial mistakes that people make in the name of tax planning.

 ***Internet Resources***

These alert you to special Internet resources: articles, explanations, financial planning tools and calculators, and selected products and services to help you implement these strategies.

 ***Sources***

Here you'll find sources and citations to verify strategies discussed in the plan

IRC = Internal Revenue Code

Regs. = Treasury Regulations

Rev. Rul. = Revenue Ruling
Rev. Proc. = Revenue Procedure
PLR = Private Letter Ruling
IR = Internet Revenue Notice
TD = Treasury Decision

Introduction: Understand Tax Brackets

Adjusted gross income minus deductions and exemptions equals taxable income. Once you determine your taxable income, you can determine your actual tax. The tax system is designed to gather the most tax from those of us most able to pay. So the percentage of income you pay increases with your income. Tax brackets govern the amount of tax you pay on each dollar of income. Your “tax bracket” or “marginal rate” is the percentage you pay on your *last* dollar of income. The table at the bottom of the page lists tax bracket thresholds for various filers.

The Declaration of Independence says that all men are created equal. But not all income is created equal. Pay attention to these important exceptions to the general rates:

- Self-employment income from proprietorships, partnerships, and limited liability companies is taxed at 15.3% up to the Social Security wage base (\$102,000 for 2008) and 2.9% on income above that base. This is on top of regular income tax and replaces Social Security for self-employed taxpayers.

App. 117

- Long-term capital gains from the sale of property held more than 12 months are generally taxed at no more than 15%.
- “Qualified corporate dividends” are taxed at no more than 15%, regardless of your tax bracket.
- “Kiddie tax” is a special tax at your marginal rate on unearned income over \$900 paid to children under age 19 (or full-time students under age 24).
- Alternative minimum tax is a parallel tax intended to stop “the rich” from escaping tax entirely.
- Don’t forget state and local taxes!

Tax Brackets (2008)				
Tax Rate	Single	Head of Household	Married/Joint	Married/Separate
10%	\$0	\$0	\$0	\$0
15%	\$8,026	\$16,051	\$16,051	\$8,026
25%	\$32,551	\$43,651	\$65,101	\$32,551
28%	\$78,851	\$112,651	\$131,451	\$65,726
33%	\$164,551	\$182,401	\$200,301	\$100,151
35%	\$357,701	\$357,701	\$357,701	\$178,851

 ***Filing Guide***
IRS Publication 17.
Your Federal Income Tax

Introduction: Keep Smart Records To Audit-Proof Your Return

“Audit-proofing” your return means documenting deductions so that you can prove them if you’re audited. Today’s historically low audit rates make it pay to be aggressive. But you should file your return as if you expect to be audited. That way, if it happens, you can support your deductions and walk away a winner.

The IRS generally doesn’t require records in specific forms (except for travel, entertainment, automobiles, and gifts¹). To verify expenses, you need to show what you paid and proof that you paid it.² Canceled checks (front and back) and credit card slips can verify payments. If you don’t have a check or card slip, you can verify payment with “highly legible” bank statements.²

- **Checks** must show the check number, amount, payee, and date it was posted to the account.
- **Electronic funds transfers** must show the amount transferred, the payee’s name, and the date the transfer was posted to the account.
- **Credit cards** must show the amount charged, the payee’s name, and the transaction date.

If you’re self-employed or you own a business, your real challenge is proving the business purpose of your expense. The solution is to keep detailed written records, which you can do right in your regular appointment

App. 119

book. This verifies deductions for car and truck expenses⁴, meals and entertainment⁵, home office⁶ and business property use⁷, and more. Keep records as close to daily as possible.⁸

Recordkeeping Guidelines⁹	
IF:	THEN:
1). If you owe additional tax, and situations (2), (3), and (4), below, do not apply	3 years
2). You do not report income that you should report, and it is more than 25% of the gross income shown on your return	6 years
3). You file a fraudulent income tax return	No limit
4). You do not file a return	No limit
5). You file to amend a previous return	Later of: 3 years, or 2 yrs after tax was paid
6). You amend your return due to bad debt deduction or loss from worthless securities	7 years
7). Employment tax records for your business,	4 years
8). You sell assets used for your business	The period for the year in which you dispose of the property



Filing Guide

IRS Publication 552.

Recordkeeping for Individuals

IRS Publication 583:

Starting Business and Keeping Records



Tax Savers

Julie Morgenstern, author of *Organizing From the Inside Out* suggests archiving tax documents in a rotating six-year file: “Outfit a banker’s box with six box-bottom file folders labeled Years 1 through 6 (rather than by the year itself to avoid having to relabel annually). Keep last year’s tax records and related receipts in the Year 1 folder, the previous year’s records in Year 2, and so on. At the end of each year, toss the contents of the bottom folder (Year 6), move each set of records back one folder, and put the records from the year just ended into Year 1.”



¹IRS Pub. 552, page 2 (1999).

²IRS Pub. 552, page 3 (1999).

³IRS Pub. 552, page 3 (1999).

⁴IRS Pub 463, page 25 (2003).

⁵Reg. §1.274-5(b)(3).

⁶IRS Pub. 587, page 16 (2003).

⁷IRC §§274(d)(4), 280F.

⁸Regs. §1.274-5T(c)(1).

⁹IRS Pub. 552, page 6 (1999).

Introduction: Understand Audit Odds

You might fear that aggressive deductions wave flags in front of IRS auditors. But in truth, today's historically low audit rates mean that your odds of attracting attention are slim. And if you've properly documented legitimate deductions, you have little to fear.

Audits peaked in 1972 at one out of every 44 returns. For 2006, the rate has dropped to one out of every 107.¹ Roughly half focused on a single issue: the Earned Income Tax Credit claimed by roughly one in seven filers. (This explains high audit rates for incomes under \$25,000.) The IRS focuses the rest of its efforts on three main targets:

1. Small businesses, particularly sole proprietors operating cash businesses, who under-report income and skim receipts. (These make up the bulk of audit targets.)
2. Individual taxpayers who fail to report pass-through income from partnerships, limited liability companies, S corporations, trusts, and estates. (In 2002, the IRS launched a program matching income from those sources to recipients.)
3. Phony trusts, churches, home-based businesses, and similar frauds and protests.² (These account for most tax prosecutions—and while the IRS has lost a couple of high-profile criminal prosecutions, no court has upheld any of these theories.)

App. 122

The table below, taken from the 2004-2006 IRS Data Books, summarizes audit data for those years:

Filer	FY 2004	FY 2005	FY 2006
Form 1040 (by Income)			
\$0 – 24,999	1.26%	1.48%	1.49%
\$25,000 – 49,999	0.43%	0.60%	0.62%
\$50,000 – 99,999	0.44%	0.57%	0.62%
\$100,000+	1.39%	1.19%	1.29%
Schedule C (by Gross Receipts)			
\$0 – 24,999	3.15%	3.68%	3.78%
\$25,000 – 99,999	1.47%	2.21%	2.09%
\$100,000+	1.86%	3.65%	3.90%
“C” Corp. (Form 1120)	0.71%	1.24%	1.24%
“S” Corp. (Form 1120S)	0.19%	0.30%	0.38%
Partnerships (Form 1065)	0.26%	0.33%	0.35%



Filing Guide

IRS Publication 2193

Too Good to be True Trusts

IRS Publication 4035

Home-Based Business Tax-Avoidance Schemes

 **Tax Savers**

Just how aggressive can you get before risking penalties? You can avoid accuracy-related penalties if you have a “reasonable” basis for taking a position (generally, more than one chance in three of being accepted by the IRS) You can file Form 8275 or 8275-R, to disclose positions you believe to be contrary to law or regulations. But some advisors recommend not filing them Why volunteer Information that can attract unwanted attention?

 **Internet Resources**

The “market segmentation specialization program” publishes audit techniques guides for over 50 specific industries from Alaskan commercial fishermen to pizza restaurants and coin-operated laundries. You’ll find them online at www.irs.gov. From the home page, click “Businesses,” and scroll down to the link

Information on frauds and scams:
www.ustreas.gov/irs/ci/tax_fraud/index.htm

 **Sources**

¹IRS Data Book, 2006. Table 10

²Rev Ruls 2004-27 through 2004-32

Family, Home, and Job: Own Your Home for Tax and Investment Benefits

Despite falling real estate prices, owning your home can still be a smart long-term choice for most families. Here are three reasons why:

App. 124

1. Borrowing the bulk of your purchase price leverages your down payment and lets you profit from gains on borrowed dollars.
2. Buying, rather than renting, replaces nondeductible rent with deductible mortgage interest and property taxes.
3. You can exclude up to \$500,000 of gain from tax when you sell.

Example: You put \$20,000 down to buy a \$200,000 house. It appreciates 4%, or \$8,000, the first year you own it.

Stocks appreciate at 10-11% per year, so you're foolish to "invest" in your home, right? Not at all. Your actual investment (your down payment) is just \$20,000, and it appreciates by 40%.

Mortgage interest and private mortgage insurance are deductible within these limits:

- You can deduct interest on up to **\$1** million of "acquisition indebtedness" you use to buy or substantially improve your primary residence and one more home.
- You can deduct interest on up to **\$1** million of construction loans for 24 months from the start of construction. Interest before and after this period is nondeductible.
- Points you pay to buy or improve your primary residence are deductible if:
 - Paying points is established practice in your area;

- Points don't exceed those generally charged in the area;
- The amount is figured as a percentage of the loan amount;
- Points are specifically itemized as points, loan origination fee, or loan discount fee; and
- Points are paid directly to the lender.

Points that don't meet these tests, and points you pay on a vacation home, home equity loan, or home equity line of credit, are deductible over the length of the loan. If you sell the home or refinance it with a new lender before you fully deduct your points, you can deduct any remaining balance when you sell or refinance.



Filing Guide

Lenders report mortgage interest on Form 1098, which also goes to the IRS. Verify this amount to be sure it's correct. If not, ask your lender to correct the form. If the amounts that you and your lender report don't agree, the IRS may flag your return.

IRS Publication 530.

[Tax Information for First-Time Homeowners](#)

IRS Publication 936:

[Home Mortgage Interest Deduction](#)

☒ Tax Savers

You can tap your IRA (but not your 401(k) or other qualified plan) if you haven't accumulated enough taxable cash for your down payment. There's no

penalty for withdrawals up to \$10,000 (lifetime maximum) used within 120 days of the withdrawal for qualified acquisition costs of a “first-time homebuyer” To qualify, neither you nor your spouse may have owned a primary residence for two years before the withdrawal.

☛ *Tax Savers*

The 2008 Housing Act gives “first-time homebuyers” (those who have not owned a primary residence for three years) a tax “credit” equal to 10% of the new home’s purchase price, up to \$7,500 (83,750 for married couples filing separately) This “credit” is available for purchases from April 9, 2008 through June 30, 2009. *But*, if you take the credit, you have to pay it back, in equal installments, over the next 15 years. So it’s really just an interest-free loan, not a true tax credit. It phases out for incomes between \$75,000 and \$95,000 (\$150,000 and \$170,000 for joint filers).

☛ *Tax Savers*

If your first-year mortgage interest doesn’t justify itemizing, you get no break from deducting points you pay. Amortize them to get the tax break over the course of the mortgage then deduct any unamortized balance if you refinance the loan.

☛ *Tax Savers*

If you host business affairs at your home, consider renting it to your business for those occasions. You’ll need to establish a fair-market value for the property, and follow the usual formalities of renting property. Paying yourself rent cuts business income subject to income and self-employment tax. And you can rent your home for up to 14 days, tax-free.

Family, Home, and Job: Make the Most of Your Vacation Home

Vacation homes offer similar tax breaks as your primary residence, plus the chance to earn tax-free rent. Here's how:

- You can deduct mortgage interest you pay on up to \$1 million of "acquisition indebtedness" to buy your primary residence and one extra residence. If your mortgage debt tops \$1 million, you can still deduct the interest you pay on the first \$1 million of acquisition indebtedness. Write off the highest-rate mortgage first to maximize your break.
- You can deduct interest you pay on a loan secured by a timeshare, yacht, or motor home so long as it includes sleeping, cooking, and toilet facilities.
- If you rent your home for 14 days or less, income is tax-free.

If you rent your vacation home for more than 14 days, your rental income is taxable, but your mortgage interest, property taxes, maintenance, utilities, and other expenses to shelter that income. There are two ways to figure deductible expenses:

1. If you use the home personally for more than the greater of 14 days or 10% of the rental days, it qualifies as residential property. (Personal use includes days your family uses the house, days you rent it for below-market rates, days you trade its use for someplace

else, and time you donate as a charitable gift, but not days you use to prepare it for rental.) You'll have to report your income—but your expenses may offset it enough to avoid paying tax. To calculate the rental portion of mortgage interest and property taxes, divide the days of rental use by 365. For maintenance and utilities, divide the days of rental use by the days of total use (including rental and personal use). You can deduct rental expenses such as advertising, commissions, and travel—but not depreciation. Any losses are nondeductible personal losses.

2. If you use it personally for less than the greater of 14 days or 10% of rental days, it qualifies as rental property. To calculate the rental portion of your mortgage interest, property taxes, maintenance, and utilities, divide the days of rental use by the days of total use. (There's no separate formula for "empty days" with mortgage interest and property taxes as there is when you treat the home as residential property.) You can deduct rental expenses such as advertising, commissions, and travel. And you can deduct depreciation. If the property generates a loss, you can deduct it against outside income if you qualify for the rental real estate loss allowance or you qualify as a real estate professional.



Filing Guide

IRS Publication 527

Residential Rental Property (Including Rental of Vacation Homes)

 **Land Mines**

Many vacation homeowners donate use of their property for raffle and auctions by schools, churches, and other charities. Unfortunately, those gifts aren't deductible. What's more, days of charitable use count as personal use for purposes of qualifying your vacation home as rental property. Don't let that stop you from giving—but be aware that it might not give you the tax break you expect.

Your Business: Document “Business Intent” to Preserve Tax Breaks

If your business loses money, you can use losses to offset income from wages, interest, dividends, and so forth.¹ You can carry net operating losses back two years (for a refund of taxes you've already paid) or forward 20 years, to offset future income.² But, if your hobby loses money, your deduction is limited to your income from the hobby.³ You can't use losses to offset other income or carry them backwards or forward.

The strategies in this plan can easily turn real profits into paper losses. And the IRS is on the lookout for sham businesses established solely for tax breaks.⁴ Don't be afraid to report a loss—the IRS gets millions of Schedule Cs reporting losses each year. But if you're new in the business, your income is low, or if you operate part-time, you need to know how to protect your breaks from the “hobby loss” rule.

App. 130

The key is to prove that you started the business with the intent to make a profit.⁵ You don't need to expect it – but you do need to intend it. If you profit in three out of five years, the IRS presumes you have that necessary intent.⁶ And startup business owners sometimes misinterpret this to mean they need profits 3 years out of 5 in order to claim losses. But you can lose money year after year, and still prove your business intent by operating in a businesslike manner. (In one recent case, a cattle farmer lost money for 24 years and still proved a profit motive!⁷) Here's how to preserve your deductions:

1. Investigate your business and profit potential before starting.⁸
2. Write a business plan projecting realistic profits over time.⁹
3. Run your business like a business.¹⁰ Keep appropriate records, including a diary for appointments and expenses. Set up separate bank and credit card accounts for your business. Print business cards. Put in a business phone line. Advertise.
4. Invest in yourself. Document how you educate yourself to improve your business.
5. Work your business regularly – at least one hour a day, four to five days per week – and document that work in your business diary or records.¹¹
6. Pay extra attention if your business involves popular hobbies like antiques, traveling,

writing, raising show animals, and the like.¹² The IRS knows you'll engage in them just for the fun, and they're more likely to reclassify these businesses as hobbies.



Filing Guide

IRS Publication 334:
[Tax Guide for Small Business](#)

IRS Publication 535:
[Business Expenses](#)

IRS Publication 583:
[Starting a Business and Keeping Records](#)

☛ Tax Savers

You might still be able to deduct "hobby" losses if your hobby is sufficiently related to your business to treat both as a single activity. The Tax Court recently allowed a Palm Beach taxpayer to deduct \$561,984 in horseback riding and competition expenses because the contacts she made from that activity generated over \$1.5 million in fees for designing horse barns and homes.¹³ You need to show a genuine link, though. The Tax Court stated that 'expenses for personal pursuits do not become deductible expenses simply because they afford contacts with possible future clients.' However, in the Palm Beach case, the Court found the taxpayer's design and equestrian activities to be 'part of an integrated business plan' and that her 'clientele is almost exclusively derived from her equestrian contacts.'

💣 Land Mines

If your business doesn't show an immediate profit and you're worried you'll run afoul of the hobby loss rule,

you can file Form 5213 (within three years of the due date for the year you start the activity) to defer your “profit motive” determination until the fourth taxable year after the first year of the activity. Some advisors recommend *not* filing this form, preferring not to alert the IRS to the issue.

Land Mines

Network marketing businesses can yield surprisingly large profits. But the IRS pays special attention to network marketing businesses established primarily for tax breaks. Be especially careful documenting your profit intent here.¹⁴

Sources

¹IRC §172.

²IRC §172(b)(1)(A).

³IRC §172(b)(1)(A).

⁴Rev. Rul. 2004-32.

⁵Regs. §1.183-2.

⁶IRC §183(d).

⁷*Mullins v. US*, 94 AFTR 2d 2004-5389

⁸*Wenzel Tirheimer*, TC Memo 1992-137.

⁹*Dennis Pryor*, TC Memo 1991-109

¹⁰IRC §1.183-2(c)

¹¹*Sherman Sampson*, TC Memo 1982-276

¹²Regs. §1.183-2(b)(9)

¹³*Topping v. Comm'r*, TC Memo 2007-92

¹⁴*Ransom v. Comm'r*, TC Memo 1990-381.

Kenneth J. Nisley, TC Memo 2000-178.

Frank Harris, TC Memo 1992-638

Your Business: Strategies for “S” Corporations

“S” corporations are corporations that elect not to pay tax themselves, but to pass income and expenses directly through to shareholders. S corporations can have up to 100 shareholders, all of whom must be individuals (no nonresident aliens), estates, or certain trusts. S corporations can have just one class of shares; however, they can own taxable or “qualified subchapter S” subsidiaries.¹ S corporations offer these advantages:

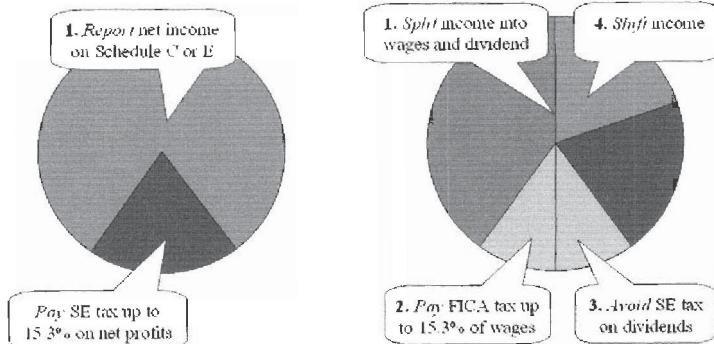
- **Avoid Self-Employment Tax.** Shareholder-employees draw salaries, reported on Form W-2 and subject to FICA tax. Corporate profits are passed through to their personal returns on Form K1, taxed as ordinary income, but not subject to FICA or self-employment tax.² (For 2008, this is 15.3% of W-2 compensation or net self-employment income up to \$102,000 plus 2.9% above that.³) You still have to pay yourself a reasonable salary.⁴ Otherwise, the IRS can recharacterize your dividend as wages and impose employment tax.⁵ “Reasonable compensation” varies from industry to industry, so be sure you can justify the salary you choose.
- **Shift Income.** You can use an S corporation to shift income to lower-bracket shareholders. You can give shares in the corporation to children or other lower-bracket beneficiaries so that their share of profits is taxed at their lower rate.

- **Avoid Audits.** S corporations can cut audit risk substantially. For FY 2006, the IRS audited 3.78% of Schedule Cs reporting incomes up to \$25,000, 2.09% of Schedule Cs reporting incomes from \$25,000 to \$99,999, and 3.90% of Schedule Cs reporting income of \$100,000 or more—but just 0.38% of all S corporations.⁷

Self-Employment vs. S Corporation

Proprietor/Partner

S Corporation



 Filing Guide

S corporations file Form 1120S then report pass-through income and deductions to shareholders on Schedule K.

IRS Publication 542: Corporations

Tax Savers

You can use S corporation losses, up to your “basis” in the business, to offset outside income from salaries, investments, and other businesses. Basis includes cash and stock you contribute to the corporation and loans you make to the corporation, but *not* loans you

personally guarantee for the corporation. If you finance a startup that you expect to lose money at first, consider using an LLC to boost your deductible losses.

Land Mines

S corporations limit qualified plan and IRA contributions based on a percentage of your income.⁶ Consider SIMPLE IRA, 401(k), or defined benefit plans for contributions not strictly limited to a percentage of salary income.

Land Mines

Some states impose special taxes on S corporation pass-through income. For example, California imposes an \$800 franchise fee plus a 1½% tax. Be sure to include these taxes to your planning.

Sources

¹IRC §1362(a)

²Rev. Rul 59-221.

³IRC §3101(a); IRC §3121(d)(1)

⁴*Rachke v. Comm'r*, 895 F 2d 1196 (7th Cir. 1996).

⁵IRC §6651.

⁶*Durando v. U.S.*, 70 F.3d 548 (9th Cir. 1995)

⁷IRS Data Book, 2006

Your Business: Strategies for “C” Corporations

“C” corporations pay tax on their income at corporate rates.¹ They can retain after-tax profits or pay them to shareholders as dividends. Dividends are taxed again as personal income at preferential rates up to 15%. This “double taxation” is more bark than bite if you “zero out” profits by paying them as salary or bonus.

App. 136

This avoids corporate tax as long as your salary is “reasonable compensation” for the services you provide.²

C corporations have none of the ownership limitations that apply to S corporations. And C corporations offer you the widest range of deductible benefits. In fact, many businesses include C corporations in their entity structure specifically to pay benefits.

- If your personal tax rate is 28% or more, you can keep up to \$50,000 in profit to be taxed at 15%, then distribute the remaining after-tax net as a “qualified corporate dividend” to be taxed at 15%. This yields an effective tax of just 27.75%.
- If your corporation pays for your life insurance (other than group term coverage up to \$50,000), the corporation pays tax on the premium and you pay tax on the value of the coverage (valued at the “PS 58” rates used to value group term life or the insurer’s annual renewable term rate, whichever is less). Those combined taxes may be less than you’d pay for insurance personally with after-tax dollars.
- Your corporation can deduct employee disability insurance premiums; however, benefits are then taxable. If you pay premiums yourself (and forego the deduction) benefits are tax-free. This sounds like a hard choice—but the IRS has ruled that you can deduct premiums until the year in which you become disabled, then forego that year’s deduction and take benefits tax-free.³

- You can borrow up to \$10,000 tax-free from the corporation⁴ so long as you show a business purpose other than avoiding tax.⁵ If you borrow more than \$10,000, you need to pay interest at least equal to the applicable federal rate (“APR”) or pay tax on the difference between your rate and the AFR.⁶
- If you own up to 50% of a partnership, LLC, or corporation, you’d like to deduct benefits for yourself, but you can’t afford to include rank-and-file employees, consider establishing a C corporation to deduct benefits for yourself without including parent entity employees. (If you own more than 50% of the parent, your corporation is part of a “controlled group” and you’ll have to offer equal benefits for both businesses.) (Your spouse can establish or use a separate business to offer deductible benefits, so long as they don’t own an interest in your parent entity or serve as director, fiduciary, or employee of that entity.⁷)



Filing Guide

C corporations file Form 1120 or 1120-A Report dividends to shareholders on Form 1099-DIV, and include them on Schedule B. Report “PS 58” costs for insurance benefits in Box 12 of Form W-2.

IRS Publication 542.

Corporations

Corporate Tax Rates (2008)	
Taxable Income	Rate
0 – \$50,000	15%
\$50,001 – 75,000	25%
\$75,001 – 100,000	34%
\$100,001 – 355,000	39%
\$355,001 – 10,000,000	34%
\$10,000,001 – 15,000,000	35%
\$15,000,001 – 18,333,333	38%
\$18,333,334+	35%

Land Mines

Personal service corporations (“PSCs”) are those whose principal activity involves personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting *and* substantially all of whose stock is owned by employees, retirees, their estates or heirs. These are taxed at a flat 35% to stop professionals from sheltering income inside the corporation.

Land Mines

Personal holding companies (“PHCs”) are closely held C corps earning 60% or more of their income from passive sources like interest, dividends, rents, and royalties PHCs pay a special 15% tax on retained PHC income to stop shareholders from using them as personal tax shelters.

 **Sources**

¹IRC §11(b).

²Regs. §1.162-7(b).

³PLRs 8027088, 9741035.

⁴IRC §7872(c)(3)(A).

⁵Regs. §1.7872-5T.

⁶IRC §7872(a)(1).

⁷Regs. §1.414(c)(4)(b)(5)(ii).

Your Business: Maximize Car and Truck Deductions

Car and truck expenses for trips on behalf of your trade or business are a deductible business expense.

Your first step involves calculating your Business Use Percentage (“BUP;” see sidebar) for your vehicle. The IRS divides mileage into three categories: 1) business; 2) commuting; and 3) personal. Ordinary commuting and personal trips are nondeductible. Trips from home to your first business stop and trips from your last business stop to home are personal. (Daily trips to the bank, post office, and similar stops where you perform no service don’t qualify.)

Travel between temporary business stops is deductible. So, for example, if you leave home, make six business stops, meet a prospect for dinner, then drive home, your mileage between your first stop and the restaurant is deductible. However, if you have a regular business stop (one that you make at least 8 to 10 times in a six-month period) that you expect to last less than a

App. 140

year, you can count those as business miles, too.¹ If home is your principal place of business, then all business trips are deductible.²

Once you've calculated your BUP, you have two ways to calculate your deduction:

1. The mileage allowance is 58.5 cents/mile (July-December 2008) *plus* parking, tolls, and your SUP of interest on your car loan and state and local personal property tax on the vehicle.³
2. With "actual expenses," deduct your BUP of all expenses:
 - Depreciation and interest (purchased vehicles)
 - Lease payments (leased vehicles)
 - Insurance
 - Gasoline, oil, and car washes
 - Tires, maintenance, repairs
 - Licenses, tags, and personal property tax
 - Parking and tolls

Don't assume that easier recordkeeping justifies settling for the "one size fits all" allowance. It's the same for every vehicle, no matter how big or expensive. And the wrong choice can cost you thousands. The American Automobile Association estimates that 2008 actual costs per mile exceed the IRS flat rate in almost all

categories of vehicles and driving habits, at a gasoline cost of \$2.941/gallon (see table).

If you own rather than lease your car, you can switch from the allowance to actual expenses. You'll have to use straight-line, rather than accelerated depreciation. You can't go the other direction, switching from actual expenses to the allowance, if you've claimed any first-year expensing or accelerated depreciation.⁴



Filing Guide

IRS Publication 463.

Travel, Entertainment, Gift, and Car Expenses

☒ Tax Savers

You can deduct costs to plaster your name and logo on your car or truck. But this won't convert personal/commuting miles into business miles.⁵

☒ Tax Savers

The IRS approves four methods to track business miles. All of them require "adequate records or other sufficient evidence" to support business use. This means logging mileage at least weekly⁶ and keeping receipts for all expenses over \$75.⁷

1. **"Brute Force."** Record every business mile for the year. Divide by the year's total miles to calculate BUP. (If you use more than one car for business, this is the method you have to use.⁸)
2. **"90 days."** Record business miles for a "typical" 90-day period. Calculate BUP for that period, and use it for the entire year.⁹

- 3. **“First Week.”** Record business miles for the first week of each month. Calculate BUP and use it for the entire year.¹⁰
- 4. **“Simplified.”** Record starting and ending mileage for a 90-day period. Record personal and commuting miles for that period, and assume all the rest are for business. Calculate BUP and use it for the entire year.¹¹

Vehicle Actual Costs (2008)			
	Miles/Yr, c/mile		
Vehicle	10K	15K	20K
Small Sedan	55.1	42.1	35.7
Med. Sedan	71.9	55.2	46.9
Large Sedan	85.8	65.1	54.8
4WD SUV	91.0	69.7	59.1
Minivan	74.9	57.6	49.1

Sources

¹Rev Rul 94-47

²IRS Pub. 17, page 193 (2003).

³IR 2005-138.

⁴Rev Proc 2002-61

⁵IRS Pub. 17, page 193 (2003).

⁶IRC §280F(d)(5).

⁷Regs. §1.274-5T(c)(3)(ii)(A)

⁸Regs. §1.274-5T(e)(3)(ii)(B).

⁹Regs. §1.274-5T(c)(3)(ii).

¹⁰Regs §1.274-5T-(c)(3)(ii).

¹¹*Frankel v. Comm'r*, 27 TCM 817 (1968)

Your Business: Buying vs. Leasing Your Vehicle

Choosing whether to buy or lease your vehicle is a common dilemma. Buying—especially full-size trucks, vans, or SUVs weighing over 6,000 pounds—yields bigger up-front deductions, and possible gain or loss when you sell. Leasing yields steadier deductions as you go along. Most authorities agree that leasing costs more—but gets you more car for the money in the short run.

If you *buy* your vehicle, you'll depreciate it over five or more years. Your actual deduction depends on your business use percentage (“BUP”).¹

- If BUP is more than 50%, use “accelerated” depreciation: 20% in Year 1 (or 5% if you buy after September 30), 32% in Year 2, 19.2% in Year 3, 11.52% in Years 4 and 5, and 5.76% in Year 6.
- If BUP is 50% or less or you're subject to the Alternative Minimum Tax, use straight-line depreciation: 10% in Year 1, 20% in Years 2-5, and 10% in Year 6.
- Special dollar limits cap deductions for passenger vehicles with gross vehicle weights under 6,000 pounds. Those limits are \$3,060 in Year 1; \$4,900 in Year 2; \$2,850 in Year 3; and \$1,775 thereafter. For 2008 only, you can claim up to \$8,000 in “bonus depreciation” for qualifying new (not used) passenger cars.
- Your actual deduction equals your BUP times the annual percentage limit—but not more than the annual dollar limit.

App. 144

- Selling your vehicle may produce a taxable gain or loss. Start with your basis when you place the vehicle in service (actual cost if placed in service new, or fair market value if used). Subtract any depreciation taken to calculate your adjusted basis, then subtract your sale price to calculate gain or loss. If your sale price is *more* than your adjusted basis, you'll "recapture" any gain attributable to business use. This is ordinary income, but not subject to self-employment tax.² If your sale price is *less* than your adjusted basis, you can deduct any loss attributable to business use.
- If selling the vehicle outright will result in a taxable gain, you can trade it in instead, treat it [sic] as a 1031 exchange, and roll the gain into the replacement vehicle.

If you *lease* your vehicle, you'll deduct the BUP of your lease payment along with these twists:

- If the vehicle's value when you place it in service tops \$15,500 (\$16,400 for trucks and vans), you'll add back a small "exclusion" amount intended to limit your deduction to what you could have depreciated had you *bought* the vehicle.³
- If you make advanced rent or capitalized cost reduction payments, you can deduct them over the course of the lease.⁴



Filing Guide

Deduct car and truck expenses on Schedule C, Form 1065, or Form 1120.

Use Form 4562 to report depreciation and first-year expensing.

IRS Publication 463:

Travel, Entertainment, Gift, and Car Expenses

☛ Tax Savers

Trucks and truck-based SUVs with gross vehicle weight ratings of more than 6,000 pounds aren't subject to the depreciation limits that apply to passenger cars. Code Section 179 lets you deduct up to \$25,000 of the purchase price for those types of vehicles in the first year.⁵

- You can use first-year expensing for a vehicle you buy as late as December 31
- You can expense a new or used vehicle
- BUP must be above 50%
- If BUP later drops below 50%, you'll have to recapture the difference between your actual deduction and what you could have depreciated using the straight-line method

First-year expensing doesn't let you deduct more than you could otherwise depreciate. You just get to deduct it faster. And you're still responsible for financing, maintaining, and insuring the vehicle. So don't buy an SUV just for the tax breaks. But don't miss the savings if it's what you really want.

 **Sources**

¹Rev. Proc. 2005-13.

²IRC §1231(a).

³Rev. Proc. 2005-13.

⁴IRS Pub. 463, page 23 (2005).

⁵IRC §179.

Your Business: Make the Most of Business Meals/Entertainment

Meals and entertainment you host in the course of your business are deductible if they're directly related to the active conduct of your business or they take place directly before or after substantial, bona fide discussion directly related to the active conduct of your business. You can deduct 50% of most meals. Specific deductions include meals, drinks, taxes and tips.

- Surroundings must be conducive to business discussion.¹
- To prove your deductions, you'll need a diary, day planner, or similar log to record your business appointments. Record the information listed in the table below.²
- You'll need receipts for expenses *over* \$75.³ Credit card statements work *if* you corroborate them by recording the business purpose of the expense in your business diary.
- You can't deduct meals with your spouse unless you're traveling together for business. However, you can include the cost of a spouse or other "closely connected" person (such as

App. 147

children or parents) if your guest brings *their* spouse.⁴

- You can deduct costs for small gatherings at your home. If you invite more than 12 guests, you can deduct “reasonable” costs if your primary purpose is business. Include employees; let guests know your business purpose; discuss and display your product or service to support your deduction.⁵
- Entertainment expenses are 50% deductible if they take place directly before or after a substantial, bona fide discussion directly related to the active conduct of your business. Deductions include the face value of tickets to sporting and theatrical events, food and beverages, parking, taxes, and tips.

Business Meals ⁶			
Amount	Time	Place/ Description	Purpose/ Relationship
Cost of the meal	Date of the meal	Establishment where the meal takes place	Purpose: Business purpose for the expense, or the business benefit gained or expected. Relationship: Occupations or other information (such as names, titles, designations) about your guest that show their relationship to you.



Filing Guide

IRS Publication 463.

Travel, Entertainment, Gift, and Car Expenses.

☛ Tax Savers

You can deduct 100% of your expenses for meals and entertainment for sales seminars and similar events where the meal is integral to the presentation.⁷ You can also deduct 100% of the cost of sporting events you organize to benefit charity, and recreation expenses for employees.⁹

☛ Tax Savers

You can't deduct membership dues for private non-business clubs. But you can deduct the costs of meals you host there.

☛ Tax Savers

You can deduct the cost of meals that you furnish employees (and yourself, unless you're taxed as a proprietor) for the convenience of the business and not for compensation. These include meals you furnish on-premises to let employees stay available for emergency calls, meals you furnish during short lunch periods (up to 45 minutes), meals you furnish where there aren't adequate eating places near the workplace, and any meals you furnish to over 50% of employees.¹⁰ You can also deduct off-premises meals you provide as part of required business meetings).¹¹

□ Sources

¹Regs. §1.274(c)(7)

²Regs. §1.274-5(b)(3).

³Rev. Rul. 95-96.

⁴Regs. §1.274-2(d)(4).

⁵IRC §274.

⁶IRS Pub 463, page 25 (2003)

⁷*Matlock v. Comm'r*, TC Memo 1992-324.

⁸IRC §274(1).

⁹IRC §274(n)(2).

¹⁰IRC §119, Regs. §1.119-1.

¹¹*Mabley v. Comm'r*, TC Memo 1965-323

Your Business: Make the Most of Business Travel

Travel costs are deductible for trips you take on behalf of your trade or business:

- You're "traveling" when you're away overnight or long enough to need sleep.¹
- "Business days" are those you spend traveling to business destinations, days where you spend the majority of working hours on your trade or business (four hours and one minute), and days where your personal presence is required at a particular place for a specific and bona fide business purpose.²
- "Business day" costs include 50% of meals and entertainment plus 100% of lodging, local transportation, incidentals, and your first load of laundry and dry cleaning back home.³
- If your spouse is a bona fide employee, traveling for a bona fide business purpose, you can deduct their costs.⁴
- Save receipts for all lodging and for any expense over \$75.⁵

App. 150

- Transportation costs include cars, planes, trains, and boats:

Deducting Transportation Costs⁶		
INSIDE the United States		
TRIP LENGTH	BUSINESS %	DEDUCT:
Less than 1 week	More than 50%	100% of transportation costs
"	50% or less	No transportation costs
1 week or more	More than 75%	100% of transportation costs
"	75% or less	Business % of transportation costs
OUTSIDE the United States		
TRIP LENGTH	BUSINESS %	DEDUCT:
Less than 1 week	75% or more	100% of transportation costs
"	Less than 75%	Business % of transportation costs
1 week or more	Any	Business % of transportation costs



Filing Guide

IRS Publication 463.

Travel, Entertainment, Gift, and Car Expenses.

IRS Publication 1542.

Per Diem Rates

☒ Tax Savers

Want to write off weekends? You can treat them as business days if they fall between business appointments⁷ or you stay over (before or after your business) to qualify for airline “Saturday stay” discounts.⁸

☒ Tax Savers

If you travel to find investment property, amortize the cost of the trip over the first 60 months you place the property in service. If you don’t find property to buy, deduct the cost of the trip as a business loss.

□ Sources

¹Rev. Rul. 54-497

²Regs. §1.274-4(d)(2)(iii)

³Rev. Rul. 63-145

⁴IRC §274(m)(3).

⁵Regs. §1.274-(c)(2)(iii).

⁶IRS Pub 463, page 25 (2003)

⁷Regs. §1.274-4(d)(2)(v).

⁸PLR 9237014.

Your Business: Separate Entities for Business Assets

If your business involves real estate or capital equipment, consider establishing a separate entity or entities to own the property, then lease it to the business. This offers several tax and asset protection advantages. The biggest may be shifting income from the business to the leasing entity. This lets you draw income in the form of tax-advantaged rent (sheltered by depreciation), rather than compensation or profits taxable as ordinary income. Here's how it works:

1. You pay \$400,000 for an office condominium, individually or in an LLC, to house your business. You put \$40,000 down and finance the remaining \$360,000 for 30 years at 7%. Your monthly payment is \$2,395 per month.
2. Your business leases the property for \$3,250 per month under a “triple-net” lease with the business assuming all operating expenses, including utilities, insurance, and property taxes.
3. At the end of the year, your real estate activities show income of \$39,000. \$28,426 is deductible as interest, leaving just \$10,574 of net income. Depreciation offsets most or all of this, leaving you with little or no taxable income.

Leasing business assets offers these additional advantages:

- You can sell or gift interests in the property without diluting your ownership or control of the business. For example, you can transfer the real estate into a family limited partnership and make gifts of partnership interests to reduce your taxable estate without giving interests in the actual business.
- You may qualify to title the entity in your spouse's name to establish employee benefit programs such as retirement plans or medical expense reimbursement plans you might not wish to establish for your primary business. (This may not work if your spouse is active in your primary business.)
- You can refinance business assets to tap equity and draw income in the form of nontaxable loans.
- You protect business assets by segregating them in different entities, making it harder for creditors of one to reach assets held in another.

 ***Tax Savers***

Establishing a separate entity to own business assets can be even more valuable if you operate as a "C" corporation. That's because any gains on assets you dispose of are taxed twice, first at the corporate level and second at your personal level. It makes no sense to "zero out" those gains by taking them as salary or bonus because it converts them from capital gains, taxed at preferential rates, to ordinary income.

Your Business: Gift-Leasebacks for Family Tax Savings

Gift-leasebacks (and sale-leasebacks) let you transfer income from yourself to lower-bracket taxpayers such as your children. You, the donor, give or sell business property to the taxpayers you wish to shift income to or to an irrevocable trust for their benefit (if they are under age 18). Then, lease it back from the recipient. This strategy essentially lets you give depreciated property to your kids, and deduct it again.

Your gift is valued at its fair market value as of the date of the gift.¹ If you give more than \$12,000 in a single year to a single donor, you'll need to file a gift tax return; however, no actual tax is payable until your lifetime taxable gifts exceed \$1 million. You and your spouse can jointly give \$12,000 to \$24,000 by consenting in writing to "split" the gift.²

Once you've made appropriate gifts, follow these rules to qualify for deductions:³

- You can't retain substantially the same control over the property you transfer. If you give property to a trust, you can avoid this issue by appointing an independent trustee.
- The lease should be in writing and specify timely payment of reasonable rent. Have the property appraised before transfer and maintain the payment schedule you specify. (You might consider a "net lease" that requires you

to pay, and thus deduct, maintenance, repairs, and the like.)

- You'll need to pay commercially reasonable rent.⁴
- You can't retain any disqualifying equity in the property after the lease—preferably, not even a reversionary interest in property gifted in trust.

The gift-leaseback has been especially useful for children age 18 or above in college or grad school:

Example: You own a fully depreciated SUV you use 100% for business. The truck's fair market value is \$20,000. You and your spouse give it to your college-age daughter, and lease it back for \$400 per month. Your arrangement creates \$4,800 in new deductions, and eliminates any self-employment tax you would otherwise have paid on that income.

But be aware that, beginning January 1, 2008, the “kiddie tax” applies to dependents under age 19, and full-time students under age 24, thus greatly limiting this strategy.



Filing Guide

Report rental income from personal property on Form 1040 (line 21, Other Income) Report rental income and expenses from real property on Schedule E. Lease income isn't subject to self-employment tax so long as you're not in the business of renting property.

Report gifts over \$12,000 (including “split” spousal gifts between \$12,001 and \$24,000) on Form 709.

 **Sources**

¹IRC §2512.

²IRC §2513.

³*Lerner v. Comm'r*, 71 TC 290;
Rosenfeld v. Comm'r, 706 F.2d 1277 (2d Cir 1983).

⁴*Logon Lumber Co. v. Comm'r*,
365 F.2d 846 (5th Cir. 1966).

⁵IRC §1402(a).

Your Business: Take Advantage of “Certain Fringe Benefits”

Code Section 132 lets you deduct “certain fringe benefits” you provide your employees—including yourself or your spouse if you qualify:

- You can pay employees a “length of service” award of up to \$400 in property (not cash) as often as every five years.¹
- You can deduct the cost of a gym or athletic facility located on your premises, operated by you, and substantially all the use of which is by your employees, their spouses, and their dependents. Facilities include your swimming pool, tennis court, and fitness equipment.² Depreciate personal property and land improvements such as pools, and deduct operating expenses such as chemicals and cleaning.
- If you offer a retirement plan (including a SIMPLE IRA or SEP) you can deduct

App. 157

“qualified retirement planning services” you provide employees and their spouses. Services aren’t limited solely to your employer plan, but don’t include related services like tax prep, accounting, or legal services.³

You can also deduct a range of “de minimis” fringe benefits. These are property and services (not cash) that the IRS doesn’t tax because their value is “so small as to make accounting for it unreasonable or administratively impractical.” The generally accepted threshold for these items is \$25.⁴

- Occasional meals or “supper money” and transportation (car service, etc.) to let employees work late.
- Occasional cocktail parties, group meals, or picnics for employees and guests.
- Traditional birthday or holiday gifts of property (not cash) with a low fair market value (\$25 or less).
- Occasional theatre or sporting event tickets.
- Coffee, juice, and doughnuts you provide for employees at the office.
- Flowers, fruits, books, or similar property you provide to employees under special occasions, such as illness, outstanding performance, or family crisis.

These may be mere rounding errors for the Microsofts of the world. But they can really add up! Most months have at least one holiday. And, while you can’t write off

season tickets as a block, those trips to the ballet or local amusement park can add up.

 ***Filing Guide***

Deduct fringe benefits as “employee benefits” on the appropriate business form or schedule.

IRS Publication 15-B.

[Employer’s Tax Guide to Fringe Benefits](#)

 ***Sources***

¹IRC §274(j).

²IRC §132(j)(4).

³IRC §132(m).

⁴IRC §132(e).

Your Business: Consider a Medical Expense Reimbursement Plan

Medical expense reimbursement plans (“MERPs”) let you reimburse your employees, their spouses, and their dependents for uninsured medical costs.¹ Plan benefits are deductible by the business, and nontaxable to the employee. Here’s how they work:

- You have to establish the plan for employees. If you run your business as a proprietorship, partnership, LLC, or “S” corporation, you’re considered “self-employed,” and not eligible.² If you’re single, you can establish a C corporation and pay benefits to yourself as an employee. If you’re married, you can hire your spouse and pay the benefits through him or her.³ If you operate as an S corporation, you

App. 159

and your spouse are both considered self-employed. (In that case, segregate part of your income through a proprietorship or C corporation and pay benefits through that entity.)

- You can't discriminate in favor of highly compensated employees.⁴ However, you can use a classification test (such as "all participants in Employer's group health plan") to qualify participants.⁵ You can also exclude those under age 25; those who regularly work less than 35 hours per week; those who work less than nine months out of the year; and those who have worked for you for less than three years.⁶
- You can't reimburse employees for costs they incur before the plan effective date.⁷

Paying medical expenses through a MERP offers several advantages:

- You can deduct 100% of your employees' health insurance. Deductible health insurance costs include major medical and supplemental premiums. Medicare premiums, qualified long-term care premiums, and Medicare supplemental ("Medigap") policies.
- Out-of-pocket medical costs include routine expenses such as co-pays, deductibles, and prescriptions; occasional expenses such as eyeglasses and dentistry; big-ticket items like orthodontics, fertility treatments, and schools for learning-disabled children.⁸ It also includes nonprescription medicines and health-care supplies.⁹ You can reimburse employees or pay health-care providers directly.¹⁰

- The plan lets you deduct 100% of your out-of-pocket costs, bypassing the usual 7.5% floor for itemized deductions. You'll also avoid any self-employment tax you would otherwise pay on amounts you deduct as plan benefits.



Filing Guide

You'll need a written plan document and summary plan description to establish the plan. No special filings are required until the plan covers 100 or more employees Report MERP benefits as "employee benefits" on the appropriate business form or schedule.

☒ Tax Savers

If you hire your spouse to qualify for a MERP, you can pay them in benefits only, rather than cash. This avoids managing payroll formalities and filing Form W-2. The key to making this work is to document your spouse's bona fide employment. Consider executing a written employment contract Track their hours, weekly or monthly to substantiate your deduction.¹¹ You'll also need to pay expenses out of the business (or show actual reimbursements to employees)¹² and show that they are "reasonable compensation" for the work your employee-spouse performs.¹³

☒ Tax Savers

If you and your spouse are eligible for both a Section 125 plan and a MERP, consider which saves more If your spouse buys health insurance through a Section 125 plan, they split the FICA savings with their employer If you reimburse them through a MERP, you'll keep all the self-employment tax savings yourself.

If you're eligible for both, consider which strategy saves more.

Sources

¹IRC §105(b).

²IRC §105(g)

³Rev. Rul 71-588; PLR 9409006

⁴IRC §105(h)(2).

⁵IRC §105(h)(3)(A)(ii).

⁶IRC §105(h)(3)(B); Regs. §1.105-11(c)(2)(iii).

⁷Rev. Rul. 2002-58

⁸IRC §105(b).

⁹Rev. Rul. 2003-102

¹⁰IRC §105(b)

(“amounts are paid, directly or indirectly”)

¹¹UIL No 162.35-02, *Speltx v. Comm'r*,

TC Summary 2006-25.

¹²*Snorek v. Comm'r*, TC Memo 2007-34.

¹³*Francis v. Comm'r*, TC Memo 2007-33

Your Business: Consider a Defined Benefit Plan

Defined benefit (“DB”) plans are traditional pensions that pay a fixed income for life. These are the most expensive qualified plans to establish, administer and fund. But they also let you deduct the biggest contributions. Here’s how they work:

1. Determine your desired retirement age and income—as much as 100% of your earned income up to \$185,000 (2008).
2. Hire an actuary to calculate the annual contribution needed to generate a fund large enough to provide your desired benefit.

App. 162

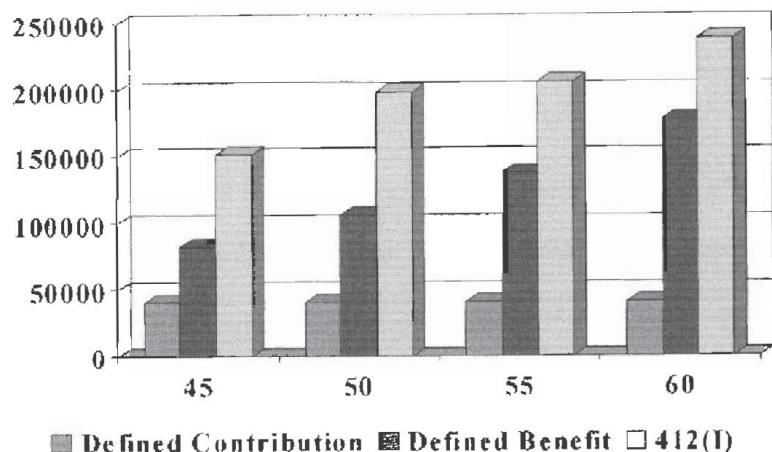
3. You can deduct as much as you need to fund your benefit.
4. Review your account balance and actuarial assumptions annually to determine your required contribution. This varies from year to year according to investment performance.
5. Annual contributions are required. This makes DB plans inappropriate if you can't commit to annual funding.

A 412(i) plan is a DB plan funded solely with life insurance, annuities, or both. These plans offer three potential advantages for older, more conservative investors:

1. The insurer calculates the premiums necessary to guarantee the benefit. This eliminates the actuary's role, making plan administration easier and cheaper.
2. The insurer guarantees benefits will be paid. This eliminates market risk and investment performance concerns.
3. Insurance and annuity contracts, with their low guaranteed rates, allow even higher deductible contributions.

The chart below illustrates just how much more you can contribute to a DB plan, according to your age and plan type. (Figures for 412(i) plans are calculated according to rules set forth in Revenue Ruling 74-123.)

Retirement Plan Contribution



Filing Guide

IRS Publication 560.

Retirement Plans for Small Business

Deadlines

Adopt a defined benefit plan by December 31 of the year for which you want [sic] deduct contributions.

Tax Savers

You can claim a credit for the cost of establishing a new small employer pension plan. It's available for employers with less than 100 employees who have not operated a qualified retirement plan. The credit equals 50% of startup costs up to \$1,000 in each of the first three years of the plan. This is part of the general business credit.

 **Tax Savers**

You can combine a DB plan with a defined contribution plan such as a SEP, profit-sharing plan, or 401(k) plan. Combined contribution limits are the same as for the DB plan alone. This gives you flexibility to contribute up to the DB limit without requiring annual contributions at that level.

 **Land Mines**

The IRS has issued rules intended to stop “abusive” 412(i) plans featuring insurance contracts with artificially low “springing” cash values that let you withdraw them from the plan at temporarily depressed rates, then “spring” to full value, thus avoiding tax on the difference. If you’re looking at a 412(i), make sure your contract doesn’t violate the new rules.¹

 **Sources**

¹Regs §1.402(a)-1(a)(2); Rev Ruls 2004-20, 2004-21.

Cashing Out: Charitable Trusts for Appreciated Assets

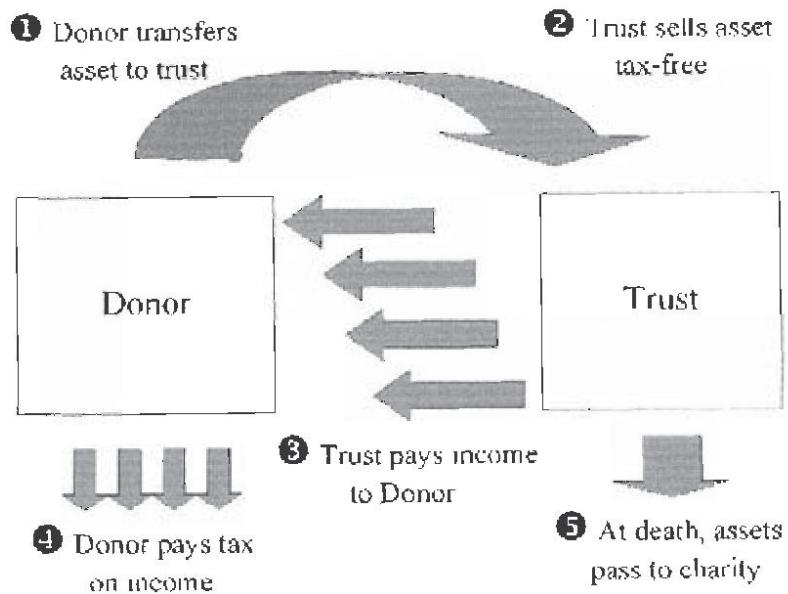
Charitable trusts let you avoid tax when you sell appreciated assets such as real estate, a business, or securities. This requires splitting the asset into two parts (an income, payable for a term of up to 20 years or a lifetime, and a remainder, payable when the income ends), and giving one to charity. The most common form is the charitable remainder trust (“CRT”). Here’s how it works:

1. Establish the trust with one or more charitable beneficiaries. You can act as trustee and manage assets yourself, subject to the “prudent trustee” rule, and even change beneficiaries.
2. Give property to the trust. You get an immediate deduction equal to the present value of the remainder interest you give, calculated according to your age, the income interest you keep, and the current “Section 7520” rate. You also eliminate the value of your gift from your taxable estate.
3. The trust sells assets, tax-free, and reinvests the proceeds.
4. The trust pays you income equal to a percentage of trust assets (“unitrust”) or a specific dollar amount (“annuitrust”). You can draw income now, or wait until a later date.
5. At your death, the trust remainder passes to charity.
6. Alternatively, a charitable lead trust pays income to charity and leaves the remainder for you or your heirs.

Example: You’re male, age 60, with \$1.0 million in stock and a basis of \$250,000. The Section 7520 rate is 5.6%:

- If you sell the stock outright, you’ll pay \$112,500 in tax, leaving \$887,500 to reinvest.
- If you give it to a CRT and keep a 6% income, you’ll get a \$312,349 deduction and keep \$1.0 million to reinvest.

Charitable Remainder Trust



Filing Guide

IRS Publication 526.

Charitable Gifts

Tax Savers

Charitable gift annuities are partially-deductible gifts in exchange for annuities payable directly from a charity. Deductions are calculated using the same rules as for charitable trusts. This avoids establishing a trust and managing assets. But there's no flexibility to invest sale proceeds or change beneficiaries. And you have to rely on the charity to make ongoing annuity payments. (Most charities buy commercial annuities to secure payments.)

 **Tax Savers**

Most donors use charitable trusts to sell appreciated assets. But you can also use them for supplemental retirement savings. You'll get up-front deductions for the income or remainder interests you give. There are no anti-discrimination rules; fewer annual reporting requirements than with qualified plans; and no required distribution dates or amounts. Remainder trusts leave nothing for your heirs. With income and estate taxes devouring over 80% of large qualified plan balances, this may be less of a problem than it seems. You can also use tax savings to buy life insurance in an irrevocable "wealth replacement trust."

State Tax Summary: California

Standard Deductions	
Single/MS	\$3,516
Joint/HH	\$7,032
Personal Exemptions	
Single/MS/HH	\$94 credit
Joint	\$188 credit
Dependents	\$94 credit each
Rates/Brackets (single filers)	
1%	\$0 – 6,622
2%	\$6,623 – 15,698
4%	\$15,699 – 24,776
6%	\$24,777 – 34,394

8%	\$34,395 – 43,467
9.3%	\$43,468 – 1,000,000
10.3%	\$1,000,001+

Interest/Dividends: U.S. government obligations exempt

Capital Gains/Losses: Same as federal

Pension/Retirement Income:

- **Private:** Same as federal
- **Public:** Same as federal
- **Military:** Same as federal
- **Social Security:** Exempt

Unemployment Compensation: Exempt

Disability Income: Same as federal

Federal Taxes: Nondeductible

Municipal Bonds: Taxable (except CA obligations)

Itemized Deductions:

- **Medical:** N/A
- **Taxes:** Generally nondeductible
- **Mortgage Interest:** N/A
- **Charitable Gifts:** N/A

Section 529 Plan: Nondeductible

Other:

 **Land Mines**

California imposes a franchise tax on business entities: 8.84% on C-Corporations (\$800 minimum), 1.5% on S-Corporations (\$800 minimum), and \$800 on LLCs, LLPs, and limited partnerships. LLCs also pay a variable fee based on worldwide receipts. Many California businesses organize as limited partnerships, to avoid the LLC franchise fees.

California LLC Fees	
Gross Receipts	Tax
\$250,001–500,000	\$900
\$500,001–1,000,000	\$2,500
\$1,000,001–5,000,000	\$6,000
\$5,000,001+	\$11,790

 **Tax Savers**

Effective for tax years beginning Jan. 1, 2007 and later, California treats registered domestic partners (“RDPs”) as if they were married, for tax purposes. RDPs generally must choose a filing status of “Married/RDP Filing Jointly” or “Married/RDP Filing Separately.” RDPs may have to adjust several items for state tax purposes to reflect differences between federal and state law. These include

- division of community property
- capital gains and losses
- transactions between RDPs
- sales of residence

- dependent care assistance
- investment interest
- rental real estate passive losses
- depreciation deduction limits

About Your Tax Planner

Dominique Molina, CPA, graduated from San Diego State University with a bachelor's degree in accounting. She began her career as a staff accountant, controller, and office manager of several closely held asset management and investment companies. Dominique broadened her exposure serving clients for the largest independently owned CPA firm in San Diego. But she eventually grew frustrated with the constraints of working for a large firm and opened her own practice to serve you better. Dominique brings you "business services from a business like yours." She's in the same trenches you are, every day: marketing her business, managing personnel, negotiating leases, securing financing, and even climbing dusty pallets to count inventory. She is actively involved in investing in real estate to achieve her personal financial goals. Dominique has over 10 years of hands-on experience with challenges most CPAs only know on paper! And that gives you a perspective most CPAs just can't offer. She's both a Certified Public Accountant and a tax coach, who integrates both disciplines into a holistic, client-centered approach towards maximizing your after-tax income and wealth. Dominique trains hard so you can sleep at night. In addition to the annual hours

she spends to maintain her certification, she spends hundreds of hours studying tax strategies and “real world” business challenges like marketing, technology, management, operations, investment, real estate and human resources. She takes that knowledge, combines it with her experience gained from hundreds of business clients, and customizes a plan just for you. Outside the office, Dominique is a wife and mother, and she considers this her best accomplishment. She loves to spend her free time with her family enjoying San Diego, surfing, reading, traveling and running. Finally, she is a classical pianist and loves all varieties of music.

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